Tax Policy Unit report in response to the amendment to the 2011 Budget regarding non-Jersey owned companies

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1. EXECUTIVE SUMMARY

1.1 Background to review

1.1.1 In 2010, the States agreed that "a new mechanism should be put in place to ensure that additional revenue is raised from certain non-locally owned non-finance companies trading in Jersey as is raised from locally owned companies trading in the Island", and requested the Minister for Treasury and Resources to "bring forward for approval the necessary legislation to give effect to this decision so that the new system can be fully implemented by 1st January 2012 provided that to do so would not jeopardise the integrity of Jersey's business tax regime or its international competitive position."

1.1.2 The reference to non-locally owned companies reflected concerns that the shareholder taxation rules (deemed distribution and full attribution) which were then in place meant that there was not a level playing field between companies owned by Jersey residents and companies owned by non-residents.

1.1.3 The shareholder taxation rules meant that a Jersey resident individual who owned an interest in a Jersey company was taxed as though they had earned the company's profits themselves. These rules did not apply to non-resident shareholders of Jersey companies. The effect of the shareholder taxation rules was that companies carrying on similar trades could have very different cash flow models, with companies owned by Jersey residents potentially under more pressure from their shareholders to distribute their profits rather than retain or reinvest them.

1.1.4 This different treatment was removed in 2011, when the shareholder taxation rules were repealed. All companies in Jersey, regardless of where shareholders are resident, are not taxed on the company's profits until those profits are distributed. In this way a level-playing field has been created.

1.1.5 Following the removal of the deemed distribution rules, the EU Code of Conduct Group found Jersey's company tax regime to be compliant in December 2011. Following the formal recognition of this compliance, work continued on reviewing the options for increasing revenues from non-locally owned companies that pay tax at 0%. This involved researching new options not previously considered, as well as reviewing and re-evaluating options that had previously been considered for addressing this issue.

1.1.6 This report represents the outcome of that review. It identifies the main options for increasing revenues and the key findings.

1.1.7 Consideration has also been given to the Council of Ministers' Strategic Plan, which was approved in May 2012 and prioritises the protection of jobs and the promotion of diversification within Jersey's economy.

1.2 Options considered and researched

1.2.1 The main options available for raising revenues from non-financial services companies include:

- **Extending the scope of the 10% or 20% band -** the focus of public comment on the company tax regime has been mainly in the retail sector, as it contains the most visible examples of non-Jersey owned companies trading in Jersey, but this could apply to any sector which is currently taxed at 0%.

- **Introducing a charge on all companies** - for example based on headcount or property occupied. The effect of any non-profit based charge has broadly the same economic effect.

- **A deemed rental charge** - whereby companies that own the property they occupy are taxed on the notional rental value of the property.

- **Restricting input GST recovery for all companies**.

- **Introducing a form of community charge** - this was suggested by a member of the public during the Business Tax Review.

1.2.2 It is worth noting that the Business Tax Review carried out in 2010 and 2011 in response to the EU Code of Conduct review, considered different types of corporate tax regimes, including for example, introducing a low rate of tax in place of the 0% rate. These have not been reconsidered given the conclusion of that review that the current company tax regime was the preferred option to protect Jersey's economy.

1.3 Economic advice

1.3.1 To help assess these options, independent economic advice has been sought from Oxera. In their report, they assess the economic impact of potential changes to the taxation or charging of Jersey companies owned by non-residents. They have concluded that any measure to increase revenues directly from non-financial services companies would be likely to result in Jersey residents indirectly paying for the change, particularly in sectors, such as retail, where many of the largest companies are owned from the UK. This would be due to increased prices (inflation), reduced wages and increased unemployment. The reports states:

"… if the objective is to somehow target companies that currently do not pay corporate profits tax, but supply goods and services into the domestic market, … in most cases, it will be Jersey residents who actually pay the tax or charge." (Oxera)

1.3.2 Oxera advises that if the intention of any reform is purely to increase States revenues, and was not specifically related to non-financial services companies, there are more economically efficient ways of doing so.

"If the objective is to raise additional government revenue then, compared to the options considered here, there are likely to be alternative approaches which are more economically efficient (ie create less deadweight loss in the economy) and for at least some of these it may also be possible to target them in a way that can meet distributional objectives (in terms of progressiveness or regressiveness) if appropriate." (Oxera)

1.3.3 The economic climate has deteriorated as this review has continued. Business confidence has suffered and is not recovering as quickly as had been hoped. Profits have declined, while unemployment has risen. The incomes of Jersey residents have been increasingly squeezed in recent years, as taxes and prices have increased faster than wages. This is unlikely to reverse in the immediate future.

1.3.4 Careful consideration should therefore be given to introducing a measure which would be likely to increase costs for Jersey residents.

1.4 Findings

1.4.1 Removing the shareholder taxation rules has removed some of the concerns about the current company tax regime..

1.4.2 There is no "perfect" way to increasing revenues from non-Jersey owned companies currently paying tax at 0%. A charge would either jeopardise the compliance of the tax regime or increase costs to Jersey residents, or both.

1.4.3 Discriminating between companies owned by Jersey and non-Jersey shareholders may deter inward investment.

1.4.4 Charging all companies that carry on an active trading activity in Jersey income tax on their profits would likely not be compliant with the Code as the general rate of tax would not be 0%.

1.4.5 However, more information should be collected from companies in Jersey to allow their profits to be accurately known. A White Paper on methods to improve the collection of this information is being issued along with this report, which invites comments on the best way to ensure the necessary information is collected. This will assist the development of future tax policy.

1.4.6 If charges were levied on companies, the additional cost would likely be passed on to Jersey residents in the form of increased prices (inflation) or through reduced wages or employment. If those charges were linked to companies' profits, they would likely not be compliant with the Code as the general rate of tax would not be 0%.

1.4.7 Charges which are based on a particular cost of production can affect demand for that particular element most immediately. Therefore, a charge based on property usage would be less likely to affect employment in the Island than other types of charge, although there would still be an impact on the economy as a whole.

1.4.8 In the future, should the economic climate improve sufficiently, consideration may be given to extending the property tax regime. Property in Jersey is taxed lightly, in particular through commercial rates. A review will be undertaken to review the scope to change the way property is taxed more generally. As an initial step, it is considered that there is an opportunity to look at the relief that landlords, and in particular non-resident landlords, claim in respect of interest, in order to ensure that the owners of property in Jersey pay the tax properly due. A commitment has already been given to undertake a review of this type and that review is underway.

1.4.9 Jersey should continue to monitor developments in international standards in taxation as well as changes in its key competitors in order to ensure that its tax system remains competitive.

1.5 Key dates in the development of the current company tax regime

Key date	Event
1997:	EU agrees wording of Code of Conduct on Harmful Practices in Tax Matters
1999:	EU Code of Conduct Group issues report on harmful tax practices in EU Member States and dependent and associated territories. Four of Jersey's tax measures are found to be harmful
2003:	Jersey voluntarily agrees to comply with the terms of the Code
June 2003:	ECOFIN confirms that the Code Group had found that none of the measures proposed by the Crown Dependencies (i.e. 0/10) were considered to be harmful
2004:	Publication of "Facing up to the Future" by the Finance and Economics Committee, proposing to replace the existing company tax regime with 0/10
November 2006:	The Code Group confirms that the 0/10 measures proposed by the Crown Dependencies are in compliance with the Code
2007:	The Isle of Man introduces 0/10
	Jersey's States debate and approve the legal framework for the introduction of 0/10
2008:	Guernsey introduces 0/10
June 2008:	Jersey introduces GST at 3%
2009:	Jersey introduces 0/10
September 2009:	Jersey, Guernsey and the Isle of Man are informed by the UK that it does not consider that 0/10 complies with the "spirit" of the Code of Conduct on Business Taxation. Jersey and the Isle of Man announce plans to defend 0/10
	The worsening global economic climate prompts a review of Jersey's finances, the Fiscal Strategy Review. At the same time, a Business Tax Review is also started, which looks at ways of making the Island's company tax system more compliant with the Code of Conduct and if possible, raising revenues
May 2010:	The Code Group announces its intention to formally review the 0/10 regimes in Jersey and the Isle of Man.
	The consultation exercise on Jersey's Business Tax Review begins

September 2010:	Jersey representatives appear before the Code Group in Brussels, and make representations regarding the 0/10 regime
December 2010:	The States approves an amendment to the 2011 Budget which calls on the Minister for Treasury and Resources to introduce measures to raise an equivalent amount of tax from non-finance, non-Jersey owned companies, provided that doing so does not damage Jersey's international competitiveness or the integrity of its tax system.
February 2011:	The Code Group, on advice from the High Level Working Party on Tax Matters, finds the interaction of the deemed distribution rules with 0/10 has harmful effects.
	Jersey announces intention to remove the deemed distribution rules.
July 2011:	The States of Jersey formally approve the removal of the shareholder taxation rules (deemed distribution and full attribution), to take effect from 31 December 2011
September 2011:	The Code Group finds that the 0/10 regime, without the shareholder taxation rules, is compliant with the Code
December 2011:	ECOFIN formally approves the 0/10 regime, without the shareholder taxation rules, as compliant with the Code

2. SCOPE OF THIS REPORT

2.1 This report sets out the background to the review and revisits the rationale for developing Jersey's tax system in its current format.

2.2 It goes on to discuss the recent pressures on the 0/10 regime from the EU and from domestic political forces.

2.3 Next, it sets out the position that Jersey is now in, with additional clarity on some aspects of the Code of Conduct, a more level playing field for investors in Jersey companies and clarification on aspects of the Code.

2.4 The options for increasing revenues from non-financial services companies are set out in Section 8, with each analysed for its potential economic impact on the Island's economy and its likely compliance with the Code of Conduct.

2.5 The appendices include additional background information.

3. BACKGROUND

3.1. Introduction

3.1.1 In 2010 the States approved an amendment to the 2011 Budget calling on the Minister for Treasury and Resources to introduce measures to increase revenues from non-Jersey owned companies paying tax at 0%, provided that any changes should not jeopardise Jersey's business tax regime or its international competitiveness. This report sets out the work that has been done to identify potentially suitable regimes, and considers the suitability of each in the current economic climate.

3.1.2 In line with the terms of the amendment agreed by the States, this review was not undertaken with a specific figure of revenue to be raised in mind. The strength of Jersey's finances is such that there is no need to increase revenues to fill a specific funding gap. Where this report refers to "increasing revenues", this should be borne in mind.

3.1.3 One of the principal objections to the introduction of the zero/ten (0/10) company tax regime in 2008 was its perceived unfairness. While most commentators acknowledged the reasons for its introduction and the need to support the finance sector, Jersey's key industry, there was also concern that the policy meant that many companies trading in Jersey would benefit at the expense of individual islanders. The matter was raised by Scrutiny panels over the years, but no workable solution could be identified.

3.1.4 The reference to non-locally owned companies reflected concerns that the shareholder taxation rules meant that there was no level playing field between companies owned by Jersey residents and companies owned by non-residents.

3.1.5 Under these rules, a Jersey resident individual who owned an interest in a Jersey company would be taxed as though he had earned the company's profits himself. These rules did not apply to non-resident shareholders of Jersey companies. The effect of the shareholder taxation rules was that companies carrying on similar trades could have very different cash flow models, with Jersey-owned companies potentially under more pressure from their shareholders to distribute their profits rather than retain or reinvest them.

3.1.6 Following the finding of the EU Code Group on Business Taxation that the shareholder taxation rules represented unfair discrimination, they were abolished in 2011. Although the abolition of the rules means that companies and shareholders are now treated identically for Jersey tax purposes, the perception of unfairness persists, possibly in part due to a lack of understanding of the way shareholders are taxed on the money they receive from their companies. This is explained in further detail in Section 7.2.

3.1.7 Work has been ongoing to identify and evaluate the different options for raising revenues from companies currently paying tax at 0%. This has been informed by the comments of the EU Code Group on the 0/10 regime. In particular, the Code Group made it clear that tax measures aimed at company shareholders may be considered to form part of the overall company tax regime. Therefore, any measure which could be considered to be part of the company tax system would be deemed to be a tax, and may thereby jeopardise the 0% general rate of tax.

3.1.8 Since this work was begun as part of the Business Tax Review in late 2009 the economic climate has steadily worsened. Careful consideration has been given to how the company tax regime can best support the States' economic growth and inward investment strategies. In particular, the likely impact on employment of any new measures must be taken into account.

3.1.9 This paper sets out the background to the introduction of the current company tax regime, the options considered to raise additional revenues from companies and an evaluation of each by reference to a number of key criteria including the potential impact on Jersey's economy and inward investment strategy. It concludes with key findings arising from the work done.

3.1.10 A key part of this work has involved understanding how Jersey's economy works and the key issues facing it at this time. Although there is no intention to increase revenues from financial services companies, as for the most part they already pay income tax on their profits[1], an understanding of the issues affecting the finance industry is key as this sector is the most important contributor to Jersey's economy. A discussion of the importance of protecting the financial services industry is set out in Section 5.

3.2. What the sectors subject to 0% tax contribute

3.2.1. Non-financial services companies, whether locally or non-locally owned, contribute to Jersey's economic well-being in a number of ways:

- Direct employment – 63% of employment is in the non-finance sector.
- Social security - Employers pay social security contributions on the salaries and wages they pay to their staff[2], monies raised from employers to fund benefits for Jersey's residents.
- GST – By providing the goods and services that people in Jersey want to buy, and collecting the GST which has gone some way to making up some of the direct tax revenues lost through the introduction of 0/10. Some companies pay GST if they have not registered for the tax (typically, if their annual turnover is less than £300,000 per year).
- Providing diversity of opportunities for Jersey's residents, who may not wish to work in the finance industry.

- Tax and social security on the wages of employees.
- Producing and distributing the goods and services that Islanders use and enjoy on a daily basis.

3.2.2. Government is trying to encourage the diversification of businesses in Jersey and this strategy has been reflected in the Council of Ministers' Strategic Plan 2011 –

[1] The majority of companies considered to trade within the finance sector are subject to income tax at 10%, but a minority are taxed at 0%. These businesses would include fund management companies, insurance companies, lawyers and accountants, although many legal and accountancy firms are structured as partnerships and as such their partners are taxed on the profits at personal tax rates.
[2] From 1 January 2012, employers' social security contributions are payable at 6.5% on earnings of up to £3,778 per month, and at 2% on earnings of between £3,778 and £12,500.

2014 and the recently published Economic Growth and Diversification Strategy prepared by the Economic Development Department.

3.2.3. Any changes made to the way in which companies are taxed must not deter inward investment if the intention to diversify the economy away from traditional financial services activities. Measures should protect the revenues the States currently receives directly and indirectly from the non-finance sector. Any changes should also support the objectives of the Council of Minister to protect and increase employment in the Island.

3.3. Principles of Jersey's long-term tax policy

3.3.1. The draft Medium Term Financial Plan for the period 2013 – 2015 is to be debated by the States in the autumn of 2012. Appendix Eleven to that document sets out a long term tax policy for the Island. This document (which is reproduced in Appendix I) sets out a number of principles which should be used to inform decisions on Jersey's tax regime.

3.3.2. Jersey's tax policy should support the Council of Ministers' economic and political policy objectives.

3.3.3. In order to do this Jersey's tax regime should have the following features:

- Stability. Jersey has a reputation for stability in its tax regime, which is a key feature of its global offering. Investors, whether financial services related or not, considering the use of Jersey need to know how they will be taxed for the foreseeable future.

- Certainty. This is linked to the point on stability. Changes should be made infrequently, after careful consideration and consultation.

- Revenues. Jersey must raise sufficient revenues to meet its spending requirements.

- Flexibility. Where a need is identified, whether to attract new business or to defend existing business, Jersey must be able to move quickly.

- Competitiveness. In all things, Jersey must ensure that it does not damage the Island's ability to effectively compete for business. In this, the Island must keep aware of events in its key competitors and in the broader world which may affect it.

- Efficiency. Any tax changes should distort taxpayer behaviour as little as possible, unless that is one of the reasons for introducing the tax in the first place.

- Cost effective. The Fiscal Strategy Review, and resulting decisions by the States to increase GST and social security and retain a maximum income tax rate, suggest that in addition to the factors noted above, taxes should be cost effective for both the States and for taxpayers.

- Fairness and equity. These are extremely difficult to define and mean different things to different people. Recent decisions on introducing "20 means 20", the desire to modernise and simplify the tax regime and the introduction of GST "protection measures" indicate that fairness and equity includes ensuring that the wealthiest pay a greater proportion of their income in tax while those on the lowest incomes are protected. It has also been recognised in recent decisions that the introduction of a competitive tax regime to encourage wealthy individuals and their businesses to Jersey is beneficial to the economy. In the absence of the direct and indirect revenues raised and the economic activity derived from this inward migration, the burden in taxpayers would be greater.

3.3.4. With the above in mind, the following principles were recommended:

- Taxation must be necessary, justifiable and sustainable.
- Taxes should be low, broad and simple. This follows the OECD's best practice guidelines regarding how countries should set their taxation regimes.
- Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest incomes are protected.
- Taxes must be internationally competitive.
- Taxation should support economic development and, where possible, social policy.

4. OBJECTIVES OF THE REVIEW

4.1 Supporting the inward investment and growth strategy

4.1.1 While Jersey continues to experience the effects of the global downturn, and with unemployment still high (though stabilising in recent months), in particular in the non-finance sector, any changes to the tax regime must promote conditions for economic growth by encouraging existing businesses to grow and attracting new business to Jersey.

4.1.2 Given the difficulties posed by the current economic climate and the high level of unemployment it will be important to limit economic distortions as far as possible and understand the economic impact locally of any changes.

4.1.3 Stability of and certainty in the tax regime is important in building and maintaining business confidence.

4.2 Protecting the company tax regime

4.2.1 The Business Tax Review found that 0/10 is still overwhelmingly favoured by the majority of Island businesses as the consequences of not being able to provide tax neutrality in a transparent and simple way to the clients of the finance sector would be significant, and make Jersey uncompetitive for the supply of a major part of the current market. Any changes to the tax system should protect the international acceptability of the 0/10 structure, which at present is driven by compliance with the Code. Key to this is the ability to demonstrate that the general company tax rate in Jersey is 0%, i.e. this is the rate of tax paid by the majority of companies in Jersey, on the majority of profits earned in Jersey, by the majority of employers in Jersey and by the majority of businesses actively carried on in Jersey. This last point has recently emerged, based on the European Commission's review of 0/10 as part of the Code Group review. This will significantly limit Jersey's scope to change the current regime while maintaining its Code compliance.

4.2.2 For 2009, the most recent year for which complete information is available, the split between Jersey incorporated companies subject to the three rates of tax is analysed as follows:

Category	**Companies**		**Total profits**		**Employees**	
0%	29,960	96.5%	1,530m	68%	33,000	75%
10%	1,000	3%	670m	30%	9,000	20%
20%[3]	40	0.5%	40m	2%	2,000	5%
Total	*31,000*	*100%*	*£ 2,240m*	*(100%)*	*44,000*	*(100%)*

4.2.3 These figures include some estimates particularly in respect of total profits as full detailed information is not available. They are however based on known data from earlier years.

[3] This includes 15 utilities companies and 25 property development and investment companies.

4.2.4 Jersey taxes companies and individuals on a residence basis, so that residents of Jersey are liable to tax in Jersey on all their income, wherever in the world it arises. A non-resident is not generally liable to Jersey tax, apart from on income earned in connection with renting or developing land or buildings in Jersey, employment income earned in the Island, or from a trade carried on in Jersey.

4.2.5 A company will be considered to be resident in Jersey for tax purposes if it is incorporated in the Island, or if it is centrally managed and controlled from Jersey. The place of ownership of a company does not determine whether that company is resident or not in Jersey. This is an approach which is common to most jurisdictions. There is an exception for companies which are incorporated here but managed and controlled in another territory, if the company is considered to be resident in that other jurisdiction and if a tax rate of at least 20% could apply.

4.2.6 "Central management and control" is a concept which refers to the highest decision making function of a company, typically the place where the directors make the highest decisions relating to matters like mergers, acquisitions or the declaration of dividends. This would ordinarily be expected to take place at board meetings but is not confined to them.

4.2.7 A company that is resident in Jersey is therefore subject to Jersey tax, albeit that the rate of tax applied in most cases is 0%.

4.2.8 This table above does not include foreign incorporated but Jersey tax resident companies taxed at 0%. Commonly companies are incorporated overseas but are tax resident in Jersey. Although some information is provided annually to the tax authorities, such as the numbers, names and addresses of such companies, no information is currently routinely collected on their levels of profitability if the companies are subject to tax at the 0% rate, as such information is not required for tax purposes. The Comptroller of Taxes has the power to obtain further information where it is relevant to a Jersey tax liability or to enable him to respond to a request for information from the tax authorities of another jurisdiction with which Jersey has signed a Tax Information Exchange Agreement, for example. Companies are also required to maintain this information.

4.2.9 One of the key findings of this review is that measures should be put in place to ensure that sufficient information is routinely collected by the States in order for it to formulate future tax policy and to demonstrate that 0% continues to be the general rate of company tax.

4.2.10 A consultation has been launched with this report to seek views on the most appropriate method of collecting this data.

4.3 Creating a sustainable tax regime

4.3.1 Stability of and certainty in the tax system is important in building business confidence and hence supporting growth. Jersey has been through significant changes in its tax regime in recent years and a period of stability would be beneficial.

4.3.2 Undertaking a fundamental change in the tax regime so shortly after introducing the current company tax regime would be destabilising and create uncertainty. Even making small changes could adversely affect confidence.

4.3.3 Any changes made must be sustainable in the medium to long term. Therefore it is important that any changes are compliant with international standards to avoid the risk of challenge.

4.3.4 If the broader business community considered that Jersey's tax regime was not sustainable in the medium to long term, it would adversely affect the Island's ability to attract new businesses or employment. Businesses will be reluctant to invest new funds if they have doubts about the tax environment in which they will be operating.

5 THE INTERNATIONAL FINANCIAL SERVICES INDUSTRY IN JERSEY

5.1 The role of Jersey in international finance

5.1.1 Jersey services the financial needs of many UK nationals living abroad and provides a tax neutral pathway for funds into other financial centres, mainly the City of London.

5.1.2 Jersey, together with the other Crown Dependencies, therefore makes a significant contribution to the liquidity of the UK market through the "up streaming" of funds, thereby substantially benefiting the UK banks and the UK exchequer. Up streaming enables deposits to be gathered by subsidiaries or branches in a number of different jurisdictions and then concentrated in one centre, such as the City of London, where the bank has the necessary infrastructure to manage and invest these funds. A recent independent report for HM Treasury[4] has demonstrated that the stock of net financing provided by the Crown Dependencies to UK banks was $332.5 billion in the second quarter of calendar year 2009, largely accounted for by the up-streaming to the UK head office of deposits collected by UK banks in the Crown Dependencies.

5.1.3 Jersey's financial services industry provides services to these clients, who need administrators, bank accounts, legal advice, accountancy services and a range of other specialist services. Much of this is carried on in Jersey and all of this creates employment and economic advantage for the Island, including but not limited to direct tax revenues.

5.1.4 Jersey's robust regulatory regime and reputation as a centre for excellence gives clients the confidence to entrust their assets to service providers in the Island.

5.1.5 The profits of this industry funded the growth and development of Jersey's economy and tax paid on those profits funded the high standard of public services that Jersey residents came to expect from the mid-1970s to the present day. However, there is no room for complacency as new financial centres, particularly in the Middle East and Asia, are rapidly developing the range of specialist skills required in order to compete for international financial services business.

5.2 What aspects of Jersey's tax regime make it attractive to the international financial services industry?

5.2.1 Jersey's tax system has a number of features which make it an attractive location for the international financial services industry.

5.2.2 *Simplicity.* Jersey, in common with many other international finance centres, offers a simple tax regime which is easy for outside investors to understand and administer.

5.2.3 *Certainty.* When deciding where to invest in or operate from, it is important that the investor can have a reasonable degree of certainty regarding the tax treatment likely to apply for, if not the life of the operation, at least a number of years into the future.

5.2.4 *Competitive rate.* Jersey offers providers of financial services a competitive tax rate of 10% or in some cases 0%[5]. Although the scope of financial services activities

[4] "Final report of the independent review of British offshore financial centres", M. Foot, October 2009 http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/indreview_brit_offshore_fin_centres.htm

[5] The majority of companies considered to trade within the finance sector are subject to income tax at 10%, but a minority are taxed at 0%. These businesses would include fund management companies,

subject to tax at 10% in Jersey is slightly wider than in Guernsey or the Isle of Man, it compares well with other financial centres. It must be noted that the headline rates of tax displayed in onshore territories can mask the true tax contribution made; companies that are subject to tax at a seemingly high headline rate of tax may, after use of deductions and exemptions, in fact pay a much lower effective rate.

5.2.5 *Supports development of crucial support services/infrastructure.* In order to provide high quality services, the Island must also educate, house and provide an adequate health service infrastructure for the workforce. There should be adequate roads, housing, telecommunications infrastructure. Sufficient public revenues should exist to support this, and Jersey's current broad tax regime provides this.

5.2.6 *Neutrality for clients.* Most international finance centres offer their clients tax neutrality, in a variety of ways. While this is not the only reason why a particular centre will be chosen, the absence of the neutrality will limit the scope of services it can provide.

5.2.7 The trust and company administration sector, which is fundamental to the rest of the financial services activities undertaken in Jersey, relies in particular on the availability of tax neutrality for its clients. Without this, it is likely that the majority of trust business would leave the Island, with a corresponding impact on jobs in other financial services sectors and the wider economy as a whole.

5.2.8 The maintenance of the ability to offer tax neutrality to international investment vehicles is a cornerstone of Jersey's existence as an international financial services centre.

5.2.9 Tax neutrality can, and is, provided in a number of ways, for example through Double Tax Agreements between governments to prevent income earned in one territory by a resident of another being taxed in both jurisdictions. Other ways of achieving tax neutrality include EU directives on the treatment of intra-EU flows of income and capital, and some jurisdictions achieve neutrality through unpublished practice and negotiation with the revenue authorities. A 0% company tax rate is simple and transparent. There is no international standard which determines tax rates.

5.2.10 Although arguably not critical to the continuing success of all non-financial services sectors, many other sectors benefit substantially from the existence of tax neutrality and a tax neutral platform is a key feature in attracting new non-finance related industries, particularly in the absence of a comprehensive double tax treaty network. The geographical limitations of many international financial centres means that they compete to attract low-footprint but high value industries. Jersey competes with other low-tax jurisdictions in attracting more of this type of business in the future. Non-financial services sectors also benefit indirectly from the success of the financial services industry, which itself is reliant on tax neutrality.

5.3 What is tax neutrality?

5.3.1 Jersey competes globally with other international finance centres and tax neutrality, particularly for highly mobile capital such as investment funds, is an important feature of these jurisdictions. All international finance centres offer a form of tax neutrality – that is, a regime that does not subject companies to additional taxation, recognising that underlying profits should be subject to tax where the assets that give rise to

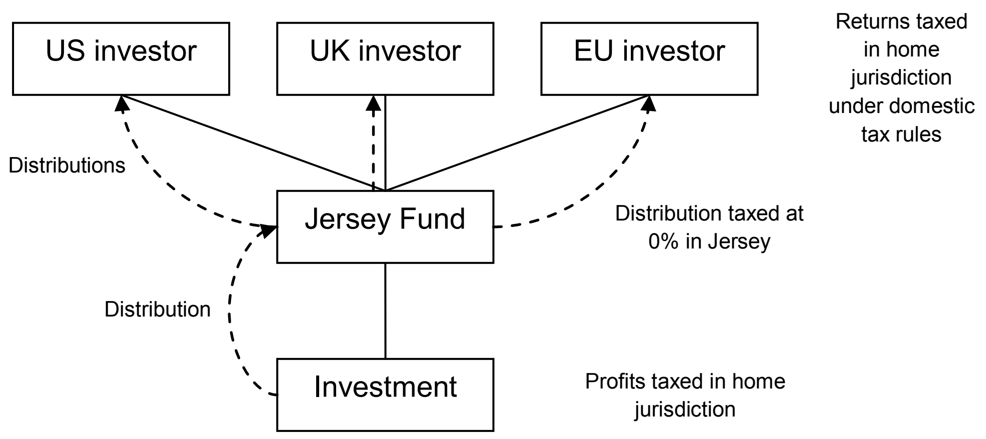
insurance companies, lawyers and accountants, although many legal and accountancy firms are structured as partnerships and as such their partners are taxed on the profits at personal tax rates.

those profits are located and investors are taxed on their returns in their home jurisdictions. Many other countries achieve tax neutrality with specific exemptions particularly for highly mobile capital and in ways which are often complex and opaque.

5.3.2 Tax neutrality is an important feature of Jersey's tax system which underpins much of the provision of international financial services from Jersey and to remain competitive access to tax neutral structures should be maintained. Although certain finance companies pay tax at no less than 10% on the profits they generate, the majority of international clients rely on the availability of tax neutrality. Tax neutrality is also important to non-financial services businesses and can influence developments in other parts of the economy.

5.3.3 Tax neutrality prevents unnecessary additional layers of taxation, provides certainty in tax treatment and allows fiscally efficient cross border investment which facilitates global capital flows. Double taxation agreements (DTAs) are used by many jurisdictions to ensure that income generated in one jurisdiction and remitted to another is, rightly, only taxed once. In the absence as yet of an extensive double tax treaty network, Jersey can only prevent unnecessary additional layers of taxation through the provision of a domestic tax neutral regime.

5.3.4 Tax neutrality also maximises the return to investors and hence, potentially, the tax revenues in their home jurisdiction. This is particularly important for structures that are set up to achieve a specific purpose, where it is desirable not to incur an unnecessary additional tax liability. Take, for example, a fund that is investing in a particular asset class such as emerging market equities and wants to attract investment from parties based in the UK, the US and the EU. If this fund is established in a jurisdiction that does not provide tax neutrality, investors in that fund may be subject to tax at the fund level in addition to their tax liability in their home country, potentially resulting in double taxation of the same income. Furthermore, such a fund may create different liabilities for investors depending on their location. By precluding additional layers of tax, a tax-neutral regime is efficient and creates a level playing field for multinational investors.



Similar tax treatment is achieved by other higher tax jurisdictions using DTAs or specific exemptions and reliefs.

5.3.5 As a consequence jurisdictions offering tax neutrality provide an ideal platform for conducting business related to international finance and trade, structuring investment deals or infrastructure projects that involve participants across a number of countries and establishing structures that can be used for a variety of other purposes, such as securitisation or the protection of assets. These legitimate activities will be primarily motivated by real economic concerns – such as the raising of finance – rather than purely for tax purposes, but locating them in a tax neutral jurisdiction, whether onshore or offshore, can avoid unnecessary extra taxation.

5.4 What the finance industry contributes to Jersey

5.4.1 The financial services sector is clearly the most economically significant in the Island, not just in terms of its direct impact (25% of private sector employment, 40.5% of GVA) but also because of the support it provides to other industries including:

- Tourism (business travel and conferences)
- Maintenance of vital air links and routes
- Construction (offices and accommodation)
- Retail (finance workers and business tourism)
- E-commerce (fulfilment and software providers)
- Agriculture (finance workers and hospitality)

5.4.2 As such, it is important not to underestimate the extent of the interaction between all sectors of Jersey's business communities.

5.5 What losing the finance industry would mean to Jersey

5.5.1 In 2004 the Finance and Economics Committee, the precursor to the Treasury and Resources Department, published a paper entitled "Facing up to the future: reforming spending and taxation to sustain a prosperous and competitive economy"[6]. This paper included a reflection on the potential consequences for Jersey of losing the finance industry, part of which is reproduced in Appendix II. Although this analysis was undertaken in 2004, the key findings remain valid.

5.5.2 That paper considered how the Island economy might look in the absence of the international financial services industry at its then level. It considered that this might have been the outcome if the States failed to introduce measures to reform the corporate tax structure in response to the pressures then being applied and which are discussed in more detail in Section 6. In particular, it looked closely at that part of financial services industry that provides services to the international markets including those serving non-resident clients.

5.5.3 It found that this part of the industry is highly mobile and it would probably be the most profitable parts that would leave first if the Island's corporate tax structure became uncompetitive and unstable. There could be a substantial change in the structure of the financial services industry within a relatively short period. There

[6] http://www.statesassembly.gov.je/ScrutinyReviewResearches/2004/20513-38936-2552006.pdf#search=facing up to the future

would be a major shock to the Island economy during the first few years after companies had gone, although they would be unlikely to leave the Island at the same time. The loss of some companies could have a bigger effect on the overall economy than others.

5.5.4 In the first few years after the shock of the emigration of these key companies:

- Employment in financial services would fall from the 12,000 then employed to around 1,200 – 1,500 jobs. Employment outside the finance sector would also fall as demand for goods and services fell.

- This would be accompanied by a considerable fall in total population, possibly by 20,000 – 22,000, with the working population falling by 14,000 – 16,000. The age structure of the Island would change as younger people would be likely to dominate the leavers, or those who no longer chose to come to Jersey as they sought employment elsewhere. This would have a knock-on effect on supporting an aging population.

- States revenues could decline by 55% - 67% per annum, but States spending could decline by much less because it would tend to be older people who would remain in the Island and the immediate liability for pensions would hardly fall at all.

- Meeting any shortfall in public revenues through tax increases or service level reductions would require higher tax rates, or deeper cuts, than meeting a similar shortfall would require from the current tax base, because the population of individuals and businesses would be lower, as would their incomes.

5.5.5 The Island would probably begin to recover after the initial shock, but the economy would look very different from the way it does now.

5.5.6 In conclusion, protecting the position of the financial services industry is key to Jersey's ongoing economic well-being. The responses to the Business Tax Review identified the current company tax regime as important to the industry and as such, it should be continued and protected into the future. No action should be taken to jeopardise the existing regime.

6. DEVELOPMENT OF ZERO/TEN

6.1 Jersey's previous company tax regime

6.1.1 Until 2008 Jersey's company tax system included the following features:

- **Exempt company** status was available to any company owned by non-residents and which, broadly, did not carry on a business activity in Jersey. Exempt companies were exempted from tax on all income earned outside Jersey and interest arising from Jersey bank accounts. An annual fee of £600 was payable.

  Exempt companies were typically used by clients of the finance industry to act as tax-neutral vehicles for the holding of investments outside of Jersey. As such, they were an important part of Jersey's ability to attract private client, funds, insurance, securitisation, trust and financing business to Jersey, i.e. the core businesses of Jersey's financial services industry. The trust and fund industries alone employed just over a quarter of those employed in the financial services industry in 2011, and 6.4% of all Islanders in work[7].

- **International Business Company** (IBC) status was also only available to companies owned by non-residents. Tax was charged at 30% on Jersey-source income and at rates between 0.5% and 20% on international income. The average annual effective tax rate (the percentage of profits before adjustments paid in tax) payable by IBCs was approximately 14%.

  Typically, IBCs were banks, group service companies and other businesses which had a presence in Jersey but whose work was "international" in nature; i.e. derived from clients based outside of the Island. The banking industry is the single largest employer in Jersey, with 5,270 employees in 2011, representing nearly 10% of total employment[8].

- **All other companies** were liable to income tax at 20% on their worldwide profits.

6.2 The Code of Conduct on Business Taxation

6.2.1 The European Union has no jurisdiction over direct taxation matters and therefore individual Member States retain the right to set their own tax rules, including their own tax rates. However, during the 1990s there was a concern that Member States were using their tax regimes to unfairly attract business away from other Member States.

6.2.2 A set of principles was devised (the Code) to which all Member States agreed to adhere. The Code requires Member States to refrain from introducing any new harmful tax measures (standstill) and to amend any laws or practices that are deemed to be harmful under the principles of the Code (rollback). It covers tax measures (including laws, regulations and administrative practices) which have, or may have, a significant impact on the location of business in the EU. The Code sets out criteria for identifying potentially harmful measures:

- An effective level of taxation which is significantly lower than the general level of taxation in the country concerned

[7] "Jersey Labour Market at December 2011", States of Jersey Statistics Unit, 28 March 2012.
[8] Ibid.

- Tax benefits reserved for non-residents

- Tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base

- Granting of tax advantages even in the absence of any real economic activity

- The basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particularly those approved by the OECD

- Lack of transparency

6.2.3 When determining whether a tax measure is harmful, the Code asks whether:

- Advantages are accorded only to non-residents or in respect of transactions carried out with non-residents

- Advantages are ring-fenced from the domestic market, so they do not affect the national tax base

- Advantages are granted even without any real economic activity and substantial economic presence within the territory offering such tax advantages

- The rules for profit determination in respect of activities within a multinational group of companies depart from internationally accepted principles, notably the rules agreed upon within the OECD

- The tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way

6.2.4 Having agreed on the principles of the Code, the EU Member States formed the Code Group, whose role is to assess tax measures against the Code principles. The Code Group then makes recommendations to ECOFIN, the European Union's Economic and Financial Affairs Council, made up of the finance ministers of the 27 EU Member States. Ultimately, it is ECOFIN's responsibility to consider these recommendations and determine whether or not to endorse them.

6.2.5 Between 1997 and 1999, the Code Group undertook an in-depth review of the tax regimes of every EU Member State and their associated and dependent territories. This review identified sixty-six tax measures with harmful features, of which forty were in EU Member States, three were in Gibraltar and twenty-three in dependent or associated territories of Member States[9]. In response, EU Member States agreed to stand still and to roll back harmful tax policies and practices identified.

6.2.6 As part of the its commitment to the Code process, the UK committed that its overseas and dependant territories would also comply with the Code. Jersey voluntarily agreed to comply with the terms of the Code.

6.2.7 The measures identified in Jersey as being harmful were:

- Exempt companies

[9]http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm#code_conduct

- International Business Companies

- Specific rules for international treasury operations carried on through the Jersey branch of an international bank

- Specific rules regarding the treatment of captive insurance companies.

Further details of these regimes and the Code Group's rationale for finding them harmful are included in Appendix III.

6.2.8 By the time the EU came to review the measures, the measures applying to captive insurance companies and to international treasury operations had either already been closed to new entrants or were not used in practice. However, this was irrelevant to the Code Group, which looks at how measures could be used rather than how they are or have been used.

6.2.9 As part of Jersey's voluntarily commitment to the Code, Jersey agreed not to introduce new harmful tax measures and to take steps to unwind those harmful measures that then existed. As part of that process, it was agreed that having closed the IBC regime to new entrants from 1 January 2004, existing IBCs could be "grandfathered" and continue to benefit from the regime until 31 December 2011. The exempt company regime was to be permitted to continue until the end of 2008. 0/10 came into force for all companies from 1 January 2009, and all formerly exempt companies were then subject to the general company income tax rate of 0%.

6.2.10 Tax regimes which had similar effect in Guernsey and the Isle of Man were also identified as harmful. In response, the Isle of Man announced its intention of abolishing the then current system of company taxation and introducing a form of 0/10 to apply from 2007 onwards. The scope of the 10% rate of tax was relatively limited, applying to certain income of banks and to income derived from property in the Isle of Man.

6.2.11 Following Jersey's decision to follow the Isle of Man's lead and introduce a form of 0/10 albeit with a greater scope of activities taxable at a positive rate, Guernsey followed suit shortly afterwards, although Guernsey introduced its new regime slightly earlier than Jersey. See Appendix IV for a comparison of the scope of the 0%, 10% and 20% tax rates in Jersey, Guernsey and the Isle of Man.

6.2.12 The Code was one of a package of measures which were intended to align tax treatments across the EU members. Another feature of the so-called "tax package" was the EU Savings Directive, which was intended to discourage tax evasion and which has led to information on cross-border interest payments made to individuals being shared with tax authorities in other EU members. Jersey committed to comply with the EU Savings Directive but did so, along with the Isle of Man and Guernsey, on the same basis as Luxembourg, Austria and, at the time, Belgium. As a result, interest paid from Jersey financial institutions to EU resident individuals is subject to withholding tax (currently at the rate of 35%) which is then paid to the revenue authorities in the territory in which the individual is resident. Alternatively, the individual can choose for his information to be shared with the tax authorities in his home territory and in that case, interest payments will not be subject to withholding tax. Jersey has committed to abolishing the withholding tax option when certain conditions are met, including that all EU Member States also do so.

6.2.13 Comment on the subsequent review of Jersey's zero/ten regime by the Code Group between 2009 and 2011 is set out in Section 6.5.

6.3 International competition

6.3.1 The early 2000s saw a general reduction in company tax rates across the EU and further afield. Former Eastern Block countries like Estonia and Hungary introduced low rates in an effort to make themselves more attractive to foreign investment. Ireland dropped its company tax rate to 12.5% and Cyprus to 10%.

6.3.2 Closer to home, the Isle of Man announced its intention to introduce a 0/10 company tax regime, with a general rate of company tax of 0% for the majority of companies and a higher rate of 10% for certain financial services profits.

6.3.3 Faced with these pressures, it was clear that Jersey's top rate of company tax of 20% was no longer attractive in an increasingly competitive international environment. After much consideration and public consultation, the decision was taken that Jersey should also introduce a form of 0/10.

6.3.4 International competition continues to be a factor in assessing the suitability of any tax regime for Jersey. The years leading up to the global financial crisis saw sustained downward pressure on company tax rates worldwide[10], and although the rate of this trend has slowed in recent years, countries are still reducing company tax rates. The UK for example, is in the process of gradually reducing its highest rate of corporation tax from 30% in 2008 to 22% by 2014. The current UK government, in its Coalition Agreement, has set its aim to "create the most competitive corporate tax regime in the G20."[11] This theme has been further developed: "the primary aim of the tax system is to raise revenue, and therefore provide the fiscal stability that is a precondition for business success. At the same time, the Government believes that the corporate tax system can and should be an asset for the UK, improving the business environment and helping to attract multinational businesses and investment to the UK to support the recovery."[12]

6.3.5 The average rate of company tax in the EU in 2012 is 23.5% and in the Eurozone, 26.1%. Between 1995 and 2012, company tax rates were reduced 113 times across the current EU members, and only increased 16 times, despite more than one economic downturn in that time. Declining company tax rates would appear to be a continuing trend.

6.3.6 The EU is not Jersey's only competitor, but it is significant, particularly when Jersey is so often competing for business with financial centres such as Luxembourg, Malta and Cyprus which can offer the advantages of EU membership to their businesses, together with competitive company tax regimes.

[10] For example, the top statutory tax rates on corporate income in the EU Member States declined from an average of 35.3% in the mid-1990s to 23.5% in 2012. Source: "Taxation trends in the European Union, Data for the EU Member States, Iceland and Norway", Eurostat/European Commission, 2012 edition (http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_structures/index_en.htm)

[11] HM Government, "The Coalition: our programme for government", May 2010: http://www.cabinetoffice.gov.uk/news/coalition-documents

[12] HM Treasury and HM Revenue and Customs, "Corporate tax reform: delivering a more competitive system", June 2010: http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/corporate_tax_reform_part1a_roadmap.pdf

6.4 Designing the current company tax regime

6.4.1 0/10 was designed to meet the following key objectives:

- To ensure compliance with the Code of Conduct on Business Taxation by removing discrimination between companies based on the place of residence of their shareholders.

- To maintain the ability of Jersey to offer a tax-neutral vehicle to clients of the finance industry.

- To ensure that Jersey could offer a competitive rate of company income tax to the Island's financial services sector, recognising that this industry is the largest employer in Jersey.

- To protect States' revenues as much as possible, recognising that the finance sector was the single largest contributor to States' revenues.

6.4.2 Following its commitment to comply with the EU Code of Conduct, Jersey decided to abolish its existing company tax regime and to replace it with a general rate of company income tax of 0%. This applies to over 95% of the companies in the Island.

6.4.3 Under the previous tax regime, the general rate of tax was 20% and special treatment was given to some companies allowing them to be taxed at lower rates, or to pay no tax at all. Under the replacement regime, the majority of companies pay at the 0% rate and a minority of companies are in effect "discriminated against", which is permissible under the Code.

6.4.4 The financial services sector was chosen for the higher rate of tax on the basis that it was the single industry with the highest profits and therefore the greatest scope to generate tax contributions. Also, charging this industry some tax would not affect Jersey's competitive position provided the rate charged was not too high. The industry had previously paid tax at rates of up to 20% but, as set out in Section 6.3, the competitiveness of this rate was under increasing pressure due to the general downward trend of company tax rates globally.

6.4.5 Companies which are regulated by the Jersey Financial Services Commission as follows are subject to income tax at the rate of 10% on all of their profits:

- Registered under the Financial Services (Jersey) Law 1998 to carry out investment business, trust company business or fund services business, as an administrator or custodian in relation to an unclassified fund or an unregulated fund;

- Registered under the Banking Business (Jersey) Law 1991, other than a company registered for business continuity under that Law, pursuant to Article 9A of the Banking Business (General Provisions) (Jersey) Order 2002; or

- Holds a permit under the Collective Investment Funds (Jersey) Law 1998 by virtue of being a functionary who is an administrator or custodian mentioned in Part 2 of the Schedule to that Law.

6.4.6 These companies are collectively referred to as "financial services companies" although not all companies considered to be in the financial services industry are taxed at the 10% rate. In particular, many fund managers and insurance companies are subject to tax at 0%.

6.4.7 Because the Code is mostly concerned with harmful competition in internationally mobile sectors, it is possible to have another tax rate which applies to immobile activities. As a result, a third tax rate of 20% applies to utility companies, to profits derived from the importation and distribution of hydrocarbons, and from income arising from the exploitation of land and buildings in Jersey, including property development and extractive activities.

6.4.8 Although Guernsey and the Isle of Man have also adopted similar tax regimes, the scope of the 10% rate, and therefore the tax collected, is much wider in Jersey than in either of the other islands. The UK indicated informally when 0/10 was being designed that the width of the 10% band put Jersey's regime closer to the edge of acceptability, although in the event the Code Group determined that it was compliant (see Section 6.5). The scope for widening the 10% band further may therefore be limited.

6.4.9 The introduction of 0/10 led to a reduction in company tax receipts, as profits were not taxable until they were paid to their shareholders. In an effort to discourage Jersey residents from deferring the payment of a tax liability, and in order to discourage abuse of the 0% tax rate, specific shareholder taxation rules were introduced at the same time as 0/10. Two different types of shareholder taxation rules were introduced:

- **Deemed distribution** applied to Jersey resident individual shareholders of Jersey resident trading companies. If the company had not paid a dividend equivalent to 60% of profits within 12 months of the end of its financial year, the Jersey resident shareholder was deemed to have received a dividend equivalent to that amount, and taxed on that notional income. The remaining 40% of profits were deemed to be distributed on one of a number of trigger events, including the death or migration of the shareholder or disposal of the shares.

  Cash dividends paid subsequently would carry a tax credit, so that the shareholder was not taxed more than once on the same profits.

- **Full attribution** applied to Jersey resident individual shareholders of Jersey resident investment companies or personal service companies. A personal service company acts as an intermediary to provide the services of its owner to clients, in circumstances in which the shareholder would have been an employee of the client if it had contracted directly with him.

  Under the full attribution rules, the Jersey resident shareholder was deemed to have received a dividend equivalent to 100% of the undistributed profits of the company. The company's income was effectively treated as income of the shareholder. Again, cash dividends subsequently received were subject to a tax credit so no further tax would ordinarily be due.

6.5 Code Group review of the company tax system

6.5.1 In 2003 and 2006 assurance had been given to the Crown Dependencies that the proposed 0/10 regimes were not considered to be harmful. In June 2003 ECOFIN issued a press release[13] confirming that the Code Group had found that none of the replacement measures proposed by the Crown Dependencies were considered to be harmful and that ECOFIN agreed that the proposed replacement measures were adequate to achieve rollback of all of the harmful features previously identified by the Code Group. Further, in its report to ECOFIN dated 28 November 2006[14], the Code Group stated:

"The UK delegation, recalling the Code Group report dated 26 November 2002, explained that with the introduction of a standard rate of tax for all Isle of Man companies of 0% and a higher rate of 10% on two closely defined types of business…the Isle of Man's six harmful measures were all repealed or revoked. This was accepted as constituting the rollback of the harmful regimes."

6.5.2 The Code Group has the authority to review company tax measures that are brought before it, but will not do so until a measure has been brought into law and is being applied in practice. The 0/10 regime came into widespread effect on 1 January 2009 and in 2010 the Code Group announced its intention to formally review the regime for compliance with the Code of Conduct, having previously confirmed, as noted above, that the concept of 0/10 in itself had no harmful effects.

6.5.3 Although it was Jersey's contention that the shareholder taxation rules were a personal tax anti-avoidance measure and not a part of the company tax regime, the Code Group ultimately considered that measures which affected shareholders could also be considered to be a part of the company tax system, in certain circumstances.

6.5.4 This point was referred to the EU's high level working party on tax issues, who were asked to review the scope of the Code. The working party decided that because the shareholder was deemed to be taxed on the profits earned by a company, not just those distributed, then this was not a personal tax anti-avoidance measure but a way of taxing company profits.

6.5.5 The Code Group found that the 0/10 parts of the 0/10 regime were compliant with the Code, but that the shareholder taxation measures taken together with the 0/10 company tax rates were a way of discriminating against Jersey resident shareholders in favour of non-residents.

6.5.6 The outcome of the Code Group assessment means that measures which affect the tax treatment of shareholders must be taken into consideration when considering the tax treatment of companies in certain circumstances. The shareholder taxation rules, then, when taken together with the 0/10 regime, were considered to have the impact of imposing a different tax treatment on Jersey companies than that which applied to companies owned by non-residents. The Code Group considered that the combination of the 0/10 and shareholder taxation rules meant that the regime as a whole discriminated in favour of companies owned by non-residents and was therefore harmful.

6.5.7 However, the concept of 0/10 on a stand-alone basis was not harmful and did not discriminate unfairly between companies. This was consistent with the Code Group's findings in 2003 and 2006.

[13] EU Council of Economic and Finance Ministers; *Press release 9844/03 (Presse 149) dated 3 June 2003*

[14] EU Code of Conduct Group (Business Taxation), *Report to ECOFIN Council 15472/06 LIMITE FISC 145 dated 28 November 2006*

6.5.8 Because only EU Member States can sit on the Code Group, Jersey cannot participate in their discussions. As a result, it can be difficult for non-members such as Jersey to understand how particular tax measures will be judged under the Code.

6.5.9 The States decided to abolish the shareholder taxation rules in order to remove the elements of the regime which the Code Group found objectionable in order to ensure that 0/10 was compliant. This was done in July 2011, and the shareholder taxation rules ceased to apply with effect from 1 January 2012.

6.6 Business Tax Review

6.6.1 At the same time that the Code Group was reviewing 0/10, a review of Jersey's business tax regime was undertaken by Treasury and Resources. This review examined the way in which Jersey taxes the profits of companies and examined potential alternatives to 0/10 in the event that 0/10 was found to be non-compliant with the Code. Part of this review involved a public consultation on the merits of the different types of alternative tax regime that could be possible, while still permitting Jersey to maintain a competitive rate of tax and the ability to offer tax neutrality to clients of the financial services industry.

6.6.2 The aims of the review were:

- To understand the nature and focus of the international pressure then being applied to change Jersey's corporate tax system;
- To protect existing corporate tax revenues; and
- To determine whether an alternative regime or changes to the existing regime could result in an increase in tax.

6.6.3 When the Business Tax Review began, Jersey had been advised that the EU Code Group considered that 0/10 did not comply with the spirit of the Code of Conduct, but before the decision was taken to formally review it. The focus of much of the early work done was on identifying potential alternative tax regimes which would be suitable for the Island. By the time it was announced that the Code Group intended to formally review 0/10 it had become clear that it was not 0/10 that was the problem, so much as its interaction with the shareholder taxation rules. It was decided at that stage, and based on early indications from the Business Tax Review that 0/10 was the preferred tax regime, to focus on defending the 0/10 regime, which was ultimately successful. The scope of the Business Tax Review was then extended to this review following the States approval of the amendment to the 2011 Budget to review ways to increase revenues from non-financial services companies, as covered in this report.

6.6.4 The findings of the Business Tax Review were as follows:

- The clear outcome of the Code Group's assessment was that the personal tax anti-avoidance rules, the deemed distribution and attribution provisions, fell within the scope of the Code and gave rise to harmful effects.
- There was nothing in the Code Group's findings to indicate that the concept of 0/10 in itself would give rise to harmful effects. This was further supported by the findings of the Code Group in 2003, confirmed by ECOFIN at that time, which

concluded that 0/10 did not give rise to harmful effects. This was prior to the introduction of the deemed distribution and attribution provisions.

- The overwhelming response to the public consultation was that before considering any changes to the regime, the Government should fully understand the focus of the international pressures to change.

- The majority of responses to the consultation also stated that 0/10 was preferable to any of the other options and should be maintained, amended if necessary to ensure it is compliant with the Code.

- The majority of respondents to the consultation supported the principles set out in the consultation document, particularly those of simplicity, certainty and the provision of tax neutrality.

- A review of the alternative corporate tax regimes, including the economic impact analysis, concluded that moving to an alternative regime, when Jersey's key competitors were not moving to a similar regime, would not increase tax revenues. In most cases, it would reduce tax revenues, and in some cases this would be significant, either due to the complexity of the regime, perceived instability in the tax regime or the uncertainty in providing tax neutrality in some key sectors.

- In respect of non-financial services companies, distinguishing between locally and non-locally owned companies would likely have an adverse economic impact and could be seen as discriminatory.

- Introducing a charge instead of a tax for companies currently subject to tax at 0% would have an adverse economic impact, particularly in terms of Jersey's ability to attract new business, and is not an efficient or effective method of raising revenues. This would be a cost to business and would not be based on ability to pay.

- Subjecting all companies to corporate tax at 10% is also, in some circumstances and particularly for UK-owned companies, an additional cost of doing business although it would be based on profits and therefore the ability to pay.

- In order to protect the current tax regime from future challenge by the EU Code Group it is critical that the general rate of tax for companies in Jersey is demonstrably 0%.

- The most recent business tendency survey[15] suggests that while financial services companies are optimistic about the future and seeing signs of recovery, the same does not apply to companies outside the financial services sector, for which 9 out of 10 of the indicators were negative. In addition, there is a risk that increasing the cost of doing business in Jersey through either charges or corporate tax would result in increased prices of goods and services for Jersey companies.

6.6.5 The clear conclusion of the Business Tax Review was that the 0/10 tax regime should be maintained, and that measures should be taken to ensure its survival.

[15] Jersey Business Tendency Survey June 2011:
http://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=601

7 WHERE JERSEY IS NOW

7.1 Clarity on the company tax system

7.1.1 The findings of the Code Group's review of 0/10, endorsed by ECOFIN in 2011, mean that there can be certainty that the 0/10 regime complies with the Code of Conduct on Business Taxation.

7.1.2 The Business Tax Review also highlighted the importance of the regime to the Island's business community, which strongly endorsed it as the most suitable tax system for Jersey.

7.1.3 Having arrived at that conclusion, it is important that the 0/10 regime is protected.

7.2 A more level playing field

7.2.1 One of the principal objections to the 0/10 regime was the perception that it was unfair in the way that it treated Jersey-owned businesses compared to foreign-owned businesses. This has been called at times the "Boots problem", referring to the UK-owned chemists and their treatment compared with competing but locally-owned chemists.

7.2.2 Before the abolition of the shareholder taxation rules, there was some justification in that argument. Until that point, a Jersey resident individual who held shares in a Jersey company was taxed on the company's profits even if they were not distributed to him. A UK-resident shareholder was not taxed in the same way. This had the potential to force different companies in the same industry to operate different business models, with Jersey-owned companies potentially under more pressure to distribute profits to shareholders as they arose, instead of retaining and reinvesting profits.

Example: Operation of the shareholder taxation rules: comparison of the tax positions of a UK and Jersey resident individual shareholder in a Jersey company, assuming no distribution of profits

	UK shareholder	*Jersey shareholder*
	£	*£*
Company profits	*100*	*100*
Deemed dividend @ 60% of profits	*0*	*60*
Jersey income tax @ 20%	***0***	***12***

Note: if no cash distributions were made, the sale of the shares, death or emigration of the shareholder or any other "trigger event" would also cause the deemed distribution of the remaining 40% of the company's profits, to be assessed on the Jersey resident shareholder.

No UK tax arises in this example because UK tax only applies to actual distributions, not deemed distributions.

7.2.3 Jersey has a residence system of taxation, which means that it applies tax based on the place in which a taxpayer is resident. This is not unlike many other jurisdictions.

A Jersey resident is liable to tax on all their income, wherever it is earned in the world.

7.2.4 A non-resident is not generally liable to Jersey tax, apart from on income earned in connection with renting or developing land or buildings in Jersey, employment income earned in the Island, or from a trade carried on in Jersey.

7.2.5 This "territorial basis" of taxation for non-residents is a commonly-used system of taxation. It is applied, for example, throughout most of the EU and in particular in the UK.

7.2.6 The UK is important because the majority of Jersey's foreign direct investment comes from there. Therefore, it is important to consider how UK resident shareholders will be affected by changes to Jersey's tax rules. It would be undesirable to do anything which would make it less attractive for UK resident companies and individuals to invest in Jersey as it is our main trading partner.

7.2.7 However, significant though the UK is to the Island's economy, it must also be borne in mind that Jersey is an international finance centre, and as a small open economy welcomes investment from any reputable source. Every country has its own tax rules. It is not possible to predict with any degree of accuracy how a change to the Jersey tax treatment of an item will affect investors in every country. However, an individual resident in a jurisdiction which applies a residence basis of taxation will normally be charged tax on dividends received from overseas.

Example: Tax position of a UK resident individual liable to tax at the highest rate on receipt of a dividend from a Jersey company subject to the 0% rate of tax

	UK shareholder
	£
Dividend received	*100*
UK income tax @ 50%[16]	***50***

7.2.8 When a Jersey resident shareholder received a dividend from a company in respect of which he had previously been subject to the shareholder taxation rules, a credit was given for tax previously paid. No such credit would be available to a UK resident individual shareholder, who would be taxed in full on the amount received.

7.2.9 Despite the deemed distribution rules not applying to the overseas resident shareholder, any advantage given was a matter of the timing of when the tax fell due for payment only. Indeed, as many territories apply higher personal tax rates that Jersey does, in many cases the tax eventually payable by the overseas resident shareholder would be significantly higher than the tax paid in Jersey by a Jersey resident shareholder.

[16] The top rate of personal income tax in the UK is 50% until April 2013.

Example: Tax position of a UK and Jersey resident individual shareholder in a Jersey company under the shareholder taxation rules, on payment of a dividend		
	UK shareholder £	*Jersey shareholder £*
Year 1		
Company profits	*100*	*100*
Deemed dividend @ 60% of profits	*0*	*60*
Jersey income tax @ 20%	***0***	***12***
Year 3		
Dividend received	*60*	*60*
Jersey income tax @ 20%	*0*	*12*
Less credit for Jersey tax previously paid	*0*	*(12)*
Jersey tax due	*0*	***0***
UK income tax @ 50%	***30***	*0*
Total tax paid	***30***	***12***

7.2.10 Following the abolition of the shareholder taxation rules with effect from 1 January 2012, this differential treatment has been removed. Jersey resident shareholders are not taxed unless and until they receive a distribution from their companies. The same is true for non-Jersey shareholders, subject to the tax rules in place in their country of residence. Companies involved in the same business are therefore now able to operate the same business model if required, whereby the pressure from shareholders to distribute is not influenced by tax considerations.

7.2.11 The removal of the shareholder taxation rules has had the effect of levelling the playing field so that companies owned by Jersey residents and non-residents are taxed in the same way, and their shareholders are also taxed in the same way, that is, on the distribution of profits from the company. The effect of this can be illustrated as follows:

Example: Tax position of a Jersey company owned by UK and Jersey resident individual shareholders		
	UK shareholder £	*Jersey shareholder £*
Company taxed at 0%		
Company profits	*100*	*100*
Jersey tax @ 0%	*0*	*0*
No distribution of profits	*No tax due*	*No tax due*
Company taxed at 10%		
Company profits	*100*	*100*
Jersey tax @ 10%	*10*	*10*
No distribution of profits	*No further tax due*	*No further tax due*

7.2.12 The profits of a company taxable at 0% will not be taxed until they are paid to its shareholders. Since the rates of tax applying in other territories are often higher than the Jersey rate of 20%, a higher rate of tax may ultimately be payable on the profits of a Jersey company owned by non-residents than for a company owned by Jersey residents.

Example: Tax position of UK and Jersey resident individual shareholders receiving distribution from a Jersey company taxed at 0%, following removal of shareholder taxation rules

	UK shareholder	*Jersey shareholder*
	£	*£*
Company profits	*100*	*100*
Jersey company income tax @ 0%	*0*	*0*
Distribution received	*100*	*100*
Jersey personal income tax @ 20%	*0*	*20*
UK personal income tax @ 50%	*50*	*0*
Total tax due	***50***	***20***

7.2.13 It can be seen from the example above that under the rules as they currently are, companies are subject to tax at 0% and no tax is payable unless and until an individual receives a distribution of profits from the company. If a company opts to reinvest its profits, perhaps to acquire new machinery to expand its business, rather than pay a distribution, no tax will be payable. However, at some point shareholders may require funds to be distributed and this may trigger a tax liability in their jurisdiction of residence.

7.2.14 The above illustrations show the simple example of companies with a single shareholder. The non-Jersey tax situation will vary depending on the country of residence and nature of the direct shareholder (i.e. individual, company, fund etc). These examples are used to illustrate the removal of part of the perceived unfairness in the tax system i.e. the impact of the removal of the shareholder taxation rules.

7.3 Clarification on aspects of the Code – the Gibraltar State aid case

7.3.1 Gibraltar's company tax regime was reviewed by the Code Group in 1999 at the same time as Jersey's. Aspects of that regime were found to have harmful features and in response Gibraltar announced a wholesale reform of its company tax system in 2002. This regime was immediately challenged by the European Commission as breaching the EU's State aid rules, which prevent EU Member States from using state resources to distort competition and trade inside the EU.

7.3.2 State aid is defined as an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities. Therefore, subsidies granted to individuals or general measures open to all enterprises do not constitute State aid. In some circumstances, government interventions are necessary for a well-functioning and equitable economy. Therefore it is permissible to provide State aid if it is done with the intention of achieving one of a number of policy objectives considered compatible with the overall aims of the EU, such as promoting the economic development of areas where the standard of living is abnormally low.

7.3.3 Gibraltar's constitutional relationship with the EU is different from than that of Jersey, so Jersey is not affected by State aid rules. However, the case is of interest because it could have easily been taken under the Code process (as subsequent changes to Gibraltar's tax regime have been, and are currently undergoing review) and as such it provides some guidance on how the European Courts may interpret the provisions of the Code if they were ever asked to do so.

7.3.4 Gibraltar proposed to replace the previous company income tax regime with two main taxes: a payroll tax based on the number of employees and a business property occupation tax based on floor space occupied. Companies would only be liable to tax if they made a profit, and the total combined liability would not exceed 15% of profits.

7.3.5 In order to demonstrate unlawful State aid, the European Commission needed to argue that the proposed Gibraltar tax regime met the following tests:

- Transfer of State resources. In order for a State to provide State aid, it must transfer some of its resources to the affected party. This can be done directly, through a direct grant of funds for example, or indirectly, by waiving a fee or charge properly payable to the State. The European Commission contended that because Gibraltar proposed waiving tax for certain types of companies, this represented a transfer of State resources and therefore State aid.

- Material selectivity. A measure which is available to all, or to all affected persons, is not State aid. Examples of this might include universal tax reliefs for capital investment, or the waiving of company registration fees for all companies for a period of time. The European Commission contended that the combined impact of the different taxes and charges proposed by Gibraltar was that offshore companies, which do not generally employ staff or occupy premises, would not be subject to tax in Gibraltar, at the expense of companies carrying on an active business there, which would be subject to the charges.

- Economic advantage. In order to prove the existence of State aid, there must be a measurable advantage to the party obtaining the aid. In this case, the advantage was available to those companies which were not charged the taxes and charges.

- Effect on competition and trade within the EU. It is a given that tax measures affect competition and trade within the EU, as tax advantages may be designed to encourage investment away from other EU members and towards the jurisdiction conferring the advantage.

7.3.6 The case proceeded through the European courts, finally being decided by the European Court of Justice (ECJ) in late 2011. The court held that:

- All the fees and charges to be included in a tax system were to be considered as a whole in order to identify whether any advantage was available

- The effect of the combination of all the fees and charges proposed in Gibraltar was that offshore companies with no real presence in Gibraltar were not taxed.

- This conferred an advantage on this type of company which represented unlawful State aid.

7.3.7 The ECJ held that the regime was materially selective on three grounds:

- The requirement that a company should make a profit before it became liable to tax favoured companies without profits;

- The tax cap favoured companies with low profits in relation to the number of employees and property occupied; and

- The inherent nature of the payroll tax and property occupation tax favoured offshore companies with no real physical presence in Gibraltar and which therefore did not incur a corporate tax liability.

7.3.8 The reasoning behind the finding of State aid is relevant to Jersey to the extent that the European Commission appears to have used the principle of material selectivity as one of the measures to assess whether 0/10 fell foul of the Code of Conduct during its assessment in 2010.

7.3.9 Thus it is important that Jersey can demonstrate that not only is the 0% tax rate the standard rate, imposed on the majority of Jersey companies, but also that the majority of companies which do business in Jersey are taxed at the 0% rate. Any potential option for taxing or charging non-financial services companies will need to be assessed in this light[17].

[17] A discussion of why raising charges on companies may fall within the scope of the Code is included in Section 8.5.5 below.

8 ANALYSIS OF OPTIONS

8.1 Scope of work

8.1.1 The Tax Policy Unit has reviewed the main options available for changing the regime that relates to non-locally owned companies paying tax at 0%. The following methods of increasing revenues have been considered in detail:

- **Extending the scope of the 10% or 20% band**. The focus of public comment on the perceived unfairness of the 0/10 regime has been on the retail sector, as the most visible example of non-Jersey owned companies trading in Jersey, but this could apply to any sector which is currently taxed at 0%.

- **Introducing a charge on all companies**, for example based on head count or property occupied. The effect of any non-profit based charge has broadly the same economic effect, and so this is considered as one option.

- **Restricting input GST recovery for all companies**.

- **Other options** which had previously been advanced have been reconsidered. These are the deemed rental tax and some form of community charge. The first proposal had been examined in some detail during the 2000s and had even progressed to the point where draft legislation had been lodged with the States for debate, before being withdrawn in the face of concerns from Scrutiny and industry that it was unworkable in the form then presented. The second option was suggested by a member of the public during the Business Tax Review, who proposed the introduction of a form of community charge on larger companies.

8.1.2 The Business Tax Review carried out in 2010 and 2011 considered different types of corporate tax regimes, including for example, introducing a low rate of tax in place of the 0% rate. These have not been reconsidered given the overwhelming conclusion of that review that 0/10 was the preferred option to protect Jersey's economy.

8.1.3 External economic advice has been sought from Oxera on the options considered in this review and is included in Appendix V.

8.1.4 Each option has been considered against the requirements to maintain 0/10 and their likely impact on the wider economy as a whole. Consideration has also been given to the extent to which each of the options may impact on employment, inflation and, if necessary, competition within Jersey's business community.

8.1.5 Having then reviewed the options, it was then necessary to revisit older options which had been previously advanced for extending tax revenues, namely the deemed rent proposal and the introduction of some form of community charge. These have been reconsidered in light of new developments in the Code Group's interpretation of the Code, of developments in international tax (particularly UK tax rules regarding the treatment of profits earned overseas) and any changes that would be necessary to bring them up to date.

8.1.6 Within the scope of the review, there was a degree of recognition that no "perfect" solution exists; it has not seemed likely that whatever option adopted would balance perfectly between the many requirements of the review, namely:

- Maintaining the 0% general rate of company income tax

- Not harming the economy
- Not adversely affecting employment
- Not adversely affecting inflation
- Not damaging Jersey's international competitiveness
- Resolving the question of "fairness"

8.2 Changes to the UK tax treatment of overseas income

8.2.1 One important change which has happened since 0/10 was developed is the change in the UK treatment of overseas profits of companies. Until recently, a UK company was taxed on its worldwide income, so that if a company had a branch overseas it was taxed in the UK on the profits of the branch with relief for overseas tax suffered if appropriate. Dividends received from foreign subsidiaries were also taxed. However, in the past few years the UK's thinking on the treatment of foreign profits has evolved and from 2009 some companies can claim an exemption from corporation tax on dividends paid from foreign subsidiaries. An exemption for profits of branches of UK companies located overseas has been available since 2011. The UK is moving towards a more "territorial" basis of tax.

8.2.2 Not every company will be able to avail of these exemptions, and they do not apply to individual investors who continue to be taxable on these profits as and when received. UK companies whose holdings in overseas companies is less than 10% of the total shares may not avail of the exemptions, and neither are they available where the overseas company carries on an activity which is "financial" in nature. However, the introduction of the exemptions does represent a step change in the way the UK treats foreign income.

8.2.3 This makes a difference to the tax treatment of Jersey companies because in the past a key consideration when looking at alternative revenue raising measures was whether double tax relief would be available in the UK against the Jersey " tax" charged. This was particularly relevant where the amount charged was not a "tax" based on the company's profits, but was a charge based on some other factor. Relief is only available in the UK against an equivalent tax based on profits, and if no relief is available, the cost to the UK company of doing business in Jersey increases because both the Jersey charge and the UK tax is payable on those profits arising in the Jersey company.

8.2.4 The introduction of the exemptions for foreign dividends and branch profits has removed some of the concern about ensuring that alternative Jersey revenue raising measures would result in additional tax being charged. However the issue has not gone away completely as the exemptions are not available in all cases for companies, and not at all for individuals. In addition, any tax or charge levied in Jersey since the introduction of the UK exemption will now be considered an extra cost of doing business in Jersey, as neither a tax nor a charge can be offset against UK tax.

Example: Impact of increasing Jersey tax on a UK-owned group which benefits from the exemption from UK tax on profits earned overseas

	Jersey company taxed at 0%	*Jersey company taxed at 10%*
	£	*£*
Jersey company		
Profits	*100*	*100*
Jersey tax @ 0%/10%	*0*	*10*
Distribution paid to UK company shareholder	*100*	*90*
UK tax @ 24%	*Exempt*	*Exempt*
UK tax payable	*0*	*0*
Net tax payable	***0***	***10***

8.2.5 It can be seen that increasing the rate of tax payable in Jersey becomes an increased cost to the group of doing business in the Island.

8.2.6 In addition, although UK government policy has changed in relation to foreign sources of income, UK tax policy has shown itself to be highly fluid in recent years and the possibility cannot be ruled out that the foreign profits exemptions may be withdrawn at some point. Should that happen, the question of the creditability of Jersey tax against UK corporation tax will again become of prime importance.

8.3 Interaction with States economic growth plan and Council of Ministers' Strategic Plan

8.3.1 The Council of Ministers has identified the protection and promotion of employment as a key strategic priority for its term. The States Economic Growth and Diversification Strategy says in relation to tax policy:

"As a global financial services centre, Jersey must remain competitive and deliver the stability that provides local and international investors or businesses, confidence to invest in the Island. Fiscal stability is therefore crucial, to future economic growth and an essential priority for the Jersey government."

8.3.2 Any tax policy considered should be reviewed against these policies which were adopted by the States in May and July 2012 respectively.

8.3.3 Fiscal stability and certainty builds confidence in the business community, which facilitates growth. Making frequent changes to the tax law or introducing temporary measures will create uncertainty and so damage confidence. That is not to say, however, that changes should not be made from time to time, when a convincing case can be made in order to ensure that the Island maintains sufficient revenues.

8.3.4 The independent economic advice from Oxera, as set out in this section and in Appendix V, would appear to be that to levy a significant charge on businesses in the current economic climate would have a detrimental effect on employment and investment in Jersey, which also does not meet the criteria adopted by the States. In summary, the economic advice is that:

"The appropriate tax structure will depend on the objectives being pursued. If the objective is to raise additional government revenue then, compared to the options considered here, there are likely to be alternative approaches which are more

economically efficient (i.e. create less deadweight loss in the economy) and for at least some of these it may also be possible to target them in a way that can meet distributional objectives (in terms of progressiveness or regressiveness) if appropriate.

"However, if the objective is to somehow target companies that currently do not pay corporate profits tax, but supply goods and services into the domestic market, these three approaches have limited effectiveness and, in most cases, it will be Jersey residents who actually pay the tax or charge. This is particularly the case in relation to charges and non recoverable GST where both Jersey owned and non-Jersey owned suppliers are subject to the additional tax or charge in the same way, resulting in the additional tax or charge applying to all of the Jersey based suppliers in that particular market."

8.4 Extending the scope of the 10% or 20% band

8.4.1 Under the current tax regime, the general rate of company income (profits) tax is 0%. Financial services companies are taxed at a higher rate of 10%, while utility companies are taxed at 20% on their profits, as are any profits derived from land or buildings in Jersey or from the importation and distribution of hydrocarbons.

8.4.2 Although Guernsey and the Isle of Man have also adopted 0/10 tax regimes, the scope (in terms of the activities covered) of the 10% rate, and therefore the tax collected, is wider in Jersey than in either of the other islands. The UK indicated informally when 0/10 was being designed that the breadth of the 10% band put Jersey's regime close to the edge of acceptability, although in the event the Code Group determined that it was compliant. The scope for widening the 10% or 20% band further may therefore be limited if 0/10 is to remain compliant.

8.4.3 In addition, introducing a profits tax at 10% or 20% that differentiated between businesses with an active trading presence on the Island (such as all retailers, restaurants, hotels and other non-financial service providers) and those that did not, may result in 0/10 being considered harmful by the Code Group. It would likely no longer be the case that the general rate of tax in the Island was considered to be 0%, because the 0% rate would effectively be ring-fenced for companies with no active trade in the Island, particularly in light of the EU Commission's comments in their review of 0/10 in 2010/11.

8.4.4 At best, therefore, if the 10% or 20% band was to be extended, it could only be extended to include one extra sector. Even then, it is not certain that such a limited change would not adversely affect the 0% general rate of tax. The focus of this review has been on the retail sector, as the most visible example of non-Jersey owned companies trading in Jersey, but this could apply to any sector which is currently taxed at 0%.

8.4.5 When the current company tax regime was being designed in the mid-2000s a key factor was the ability of companies owned by non-residents to offset any company tax suffered in Jersey against their domestic tax liabilities in the country of residence. Of particular focus was the UK, as the majority of Jersey's overseas direct investment comes from there. At the time, the UK only permitted overseas tax suffered to be offset against a company's income if the tax was a similar tax on profits to those operated in the UK. Jersey company income tax is such a similar tax, so a UK-owned group would be able to credit Jersey tax suffered against its UK liability on any Jersey profits repatriated to the UK. As the UK tax rate was much higher than Jersey rates, Jersey tax may not, in certain circumstances, have been an additional cost for UK-headquartered groups.

8.4.6 Since the current company tax regime was introduced the UK has changed the way it taxes companies with income arising overseas. This is set out in more detail in Section 8.2. In many cases, that income will now not be taxed further in the UK. As a result, any profits tax suffered in Jersey will be an additional cost of doing business for that group. On the other hand, the overall tax rate on Jersey income would still be lower than in the past. The extent to which this change in UK tax policy will affect groups making decisions about setting up, or continuing, business in Jersey remains to be seen. These new rules do not apply to all companies, and do not apply to UK resident individuals who are still taxed on income from Jersey companies in the normal way.

8.4.7 Other countries will have different tax rules, and may tax profits derived by their residents from Jersey differently. However, as a general principle, profits earned in Jersey and paid to a resident of another country would normally be taxable in that other country.

8.4.8 Extending the scope of the 10% or 20% bands may risk appearing like “scope creep”, raising the spectre of further changes in the future. This would cause uncertainty for businesses subject to the 0% rate but uncertain of whether they would come to be taxed at a higher rate at some point. This uncertainty could be especially damaging where it affected businesses considering whether to come to Jersey and which felt they could not accurately calculate the tax cost of doing business in the Island.

8.4.9 *Affected population*

8.4.9.1 The change would be better applied to all companies in whichever sector was identified as appropriate for the additional tax, regardless of ownership, for a number of reasons.

8.4.9.2 Discrimination creates uncertainty and complexity in the tax law. It would also have the effect of deterring inward investment by non-resident businesses affected by any changes, as they would be uncompetitive compared to Jersey businesses.

8.4.9.3 The tax charged in Jersey would represent an additional cost of doing business in Jersey for overseas shareholders of Jersey companies if they were unable to obtain a domestic tax credit for Jersey tax suffered.

8.4.9.4 Dividends paid to Jersey resident shareholders would carry a tax credit equivalent to the amount of Jersey tax paid by the company, which would then be offset against the shareholder’s tax payable on receipt of the dividend. As a result there would be no increase in the tax cost to locally owned businesses. However, cash flow would be affected as under the current tax regime companies taxed at 0% can choose to roll up profits in order to reinvest them. Since no tax is charged until the profits are distributed, it is possible to defer the resulting tax liability for a short time, thereby maximising the funds available for reinvestment. This deferral would no longer be available if the company was taxed on its profits immediately.

8.4.10 *Compliance with the Code of Conduct*

8.4.10.1 It is possible that a careful expansion of the 10% or 20% tax band may not affect the compliance of the current company tax system with the Code of Conduct, as it would not involve the introduction of a new tax regime, merely the expansion of the existing one.

8.4.10.2 However, it must be possible to demonstrate that the majority of companies doing business in the Island are subject to the 0% rate.

8.4.10.3 At this time however, there is insufficient information available to be certain that extending the 10% or 20% bands would maintain the 0% general rate.

8.4.11 *Economic impact*

8.4.11.1 From an economic perspective, taxes on company income (i.e. profits) are normally considered to have a relatively low level of distortion, as only companies with profits are subject to the tax. However in the short term, the retail sector is currently under a great deal of pressure in the current economic climate and it must be expected that increasing outgoings would have an impact on decisions about location and prices.

8.4.11.2 It seems most likely that introducing a positive rate of tax on the profits of companies providing goods and services to the Jersey market would lead to those companies increasing the prices they charge to Jersey residents. An increase in inflation would be likely to follow, at least in the short term.

8.4.11.3 Although for some companies, decisions on pricing are taken on the basis of the company's level of pre-tax profits, an increase in the tax rate charged may be used as a reason to increase prices, and thereby profits.

8.4.11.4 Many non-financial services sectors have suffered a decline in profitability. As a result, the immediate potential revenue increase from introducing a tax on profits will not be significant. For example, taxing the retail sector at 10% could raise additional revenue of approximately £5 million per annum (based on the most up to date data available, the tax calculations for the 2008 year of assessment, based on profits earned in 2007 and 2008). However, it should be noted that profits have declined across all sectors since 2007/08 and therefore the likely tax revenues could be substantially lower.

8.4.11.5 The potential for additional revenue would have to be weighed against the potential impact on inflation and employment in the current climate. Tax is a cost to business which business may seek to recover in some way, either from its customers through increasing its prices, or from its employees through cutting wages or jobs.

8.4.12 *Cost and complexity of administration*

8.4.12.1 Extending the scope of the 10% or 20% tax bands would require affected companies to prepare and file tax computations for the first time since 2010. In the first year, this would require some additional work to calculate opening balances for capital allowances, losses and provisions. However, the basis for calculating the tax should be familiar to companies, having been operated by them until 2008.

8.4.12.2 Currently, it is very clear into what tax band companies fall. The 10% band depends on the regulatory status of the company, enforced by the JFSC. Utility companies in the 20% tax rate are again either named in the Income Tax Law or regulated under various laws to carry on their activity, again with an enforcement body, in this case the Channel Islands Competition and Regulatory Authority

(CICRA), which has assumed the duties of the Jersey Competition and Regulatory Authority (JCRA). Companies earning income from the exploitation of land and property in Jersey are also taxable at 20%, and it is quite clear what activities fall within the scope of tax.

8.4.12.3 Extending the scope of the 10% or 20% bands to add another industry, and in particular restricting that to non-locally owned companies, would be much less straightforward. Taking the retail sector as an example, merely defining the activities giving rise to the tax charge would be difficult. Many businesses whose principal activity is the provision of services also sell goods, such as hairdressers, garages and hotels. In order to ensure that companies which made only ancillary supplies of goods were not affected by the change, the definition would have to be complex. Some of the simplicity of the tax system which Jersey prides itself on would thereby be lost as a result. This would be further complicated if local and non-locally owned business were to be treated differently, not least in determining what constitutes non-locally owned.

8.4.12.4 Some additional resource would be required by the Taxes Office in order to review and administer the tax charged to a new industry.

8.5 Introducing a charge on all companies

8.5.1 If the aim is simply to raise revenues from a targeted portion of the taxpayer base, this may be achieved through levying charges on companies based on the amount of Island resources consumed, such as employees, floor space or value of property occupied.

8.5.2 In theory, these factors should be an indicator of the relative strength of the companies affected – if all other factors were equal, a more profitable business might be expected to hire more staff or occupy more expensive premises than a less profitable one – but in practice, and particularly when comparing different types of business, it is difficult to make this case. A start-up business may have no choice but to invest in premises and staff in the expectation of operating at a loss for some time before the business develops sufficiently to make a profit. Previously profitable companies may become loss making for a period for many reasons. Different types of business will have differing resource requirements, so a fulfilment company may need large staff numbers and floor space, while a management consultancy may require small premises and low numbers of staff to generate the same return.

8.5.3 A more profitable business may use less inputs per unit of output. An increase in the cost of those inputs is likely to be reflected in one or more of prices, wages or businesses exiting from the market.

8.5.4 *Affected population*

8.5.4.1 Given that the focus of this review is on companies that do not currently pay company income tax, it would appear reasonable that financial services companies paying tax at 10% on their profits would be exempted from any additional charge. However, as the finance sector employs the largest number of staff and occupies some of the highest value property, excluding it must limit the amount of revenue that could reasonably be expected to be raised through a charge.

8.5.4.2 Similarly, utility companies and property development companies which are already taxed at 20% on their profits would be expected to be excluded from the charge, as would importers and distributors of hydrocarbons.

8.5.4.3 It could be possible to levy the charge on all companies and come up with a mechanism for crediting it against the income tax liability of those companies which pay tax at 10% or 20%, but this would be complex, and an unusual feature of a normal tax regime. It is considered preferable to keep a system like this as simple as possible in order to minimise cost and administrative complexity.

8.5.4.4 This means that the additional revenue would have to be contributed by the remainder of businesses in Jersey.

8.5.4.5 Total private sector employment in June 2012 was 49,610, of whom 39,130 were employed on a full-time basis and 10,480 part-time[18]:

Sector	% of total private sector employment
Finance	25%
Wholesale and retail	17%
Hotels, restaurants and bars	13%
Construction	10%
Transport, storage and communication	6%
Agriculture	5%
Manufacturing	2%
Electricity, gas and water	1%
Other business activities	22%
Private sector total	**100%**

Other business activities include education, health and other services (private sector) (13%), computer and related activities (1%) and miscellaneous business activities (8%).

8.5.4.6 Gross value added per full time equivalent (FTE) employee by sector, excluding public administration, for 2010 (the most up to date figures published) was estimated as follows[19]:

[18] "Jersey Labour Market at June 2012", States of Jersey Statistics Unit, 3 October 2012: http://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=817

[19] "Jersey Economic Trends 2011", States of Jersey Statistics Unit, 14 December 2011: http://www.gov.je/Government/JerseyWorld/StatisticsUnit/FactsFigures/Pages/JerseyEconomicTrendsbooklet.aspx

Sector	GVA per FTE employee £'000	% of average across all sectors
Finance	118	186%
Electricity, gas and water	80	125%
Transport, storage and communication	68	108%
Construction	51	80%
Manufacturing	47	74%
Wholesale and retail	36	56%
Agriculture	34	53%
Hotels, restaurants and bars	27	43%
Other business activities	46	73%
Average across all sectors	**64**	**100%**

8.5.4.7 Stripping out those sectors which are currently predominantly subject to tax at the rate of either 10% or 20% leaves the following:

Sector	GVA per FTE employee £'000	% of average GVA across all sectors	% of total private sector employment
Transport, storage and communication	68	108%	6%
Manufacturing	47	74%	3%
Wholesale and retail	36	56%	17%
Agriculture	34	53%	5%
Hotels, restaurants and bars	27	43%	13%
Other business activities	46	73%	22%
Other activities taxed at 0%[20]			9%
Total	**n/a**	**n/a**	**75%**

[20] Some activities classed within the financial services and construction sectors will be subject to tax at the rate of 0%, such as legal, accountancy and building trades. However, in many cases legal and accountancy firms are established as partnerships and as such, their individual partners will be taxed on their share of profits as part of their personal tax assessment.

The transport, storage and communication category has been included because although it includes States-owned utility providers, taxed at 20%, it also contains a proportion of private sector undertakings subject to the 0% tax rate.

8.5.4.8 Excluding the sectors which currently pay tax from the scope of any charge would restrict the tax base – the number of businesses subject to the charge – and the amount of revenue which may be expected to be raised, even if it was considered possible to charge all companies identically.

8.5.4.9 The charge would be applied to the less profitable sectors of Jersey's economy.

8.5.4.10 Finally, it may not be desirable to increase the cost of production for exporters, so the agriculture and tourism sectors may be removed from the scope of the charge. This leaves the wholesale and retail sector. Levying charges on both wholesalers and retailers would effectively mean that the charges would be felt more than once through the supply chain and, for any level of charge, more revenue would be raised. However, raising more revenue is likely to have a greater inflationary effect. This may leave the retail sector as the most appropriate sector to charge, if only one sector was to be chosen.

8.5.4.11 Retail is the supply of goods to the public, as distinct from the wholesale sector which supplies goods to other businesses, including retailers. However, a business such as a hairdresser, garage or hotel may often sell goods to the public, but that supply is ancillary to their main trade, which is providing services to the public. Any attempt to come up with a narrow definition is likely to prove complex, and it may not be immediately clear to certain types of business whether they fall within the scope of the charge or not.

8.5.4.12 A key differentiating factor between charges and taxes is that charges are payable regardless of whether a business makes a profit. As such, a charge is an absolute fixed cost of doing business. This could act as a deterrent to new businesses starting up in Jersey or those with low profits, where can result in the new or less profitable businesses paying a higher price for each unit it produces or sells than its competitors. The economic impact of this is explored in more detail below.

8.5.4.13 In order to minimise the disincentive for new businesses, it may be desirable to incorporate a temporary exemption for new businesses, potentially phasing the full effect of the charge in over a period of 3-5 years. This would support the States' economic policy to encourage new business in the Island, but would have the downside of encouraging "churn", whereby there is an incentive to set up a company, unwind it after a few years, then set up a new company to carry on essentially the same business, with the intention of repeating the action in a few years' time. Anti-avoidance rules would be required in order to prevent companies from attempting to avoid the charge in this way. Again, this would add to the complexity of the system.

8.5.5 *Compliance with the EU Code of Conduct*

8.5.5.1 A charge is not a tax and therefore in theory should not be subject to the provisions of the EU Code of Conduct on Business Taxation.

8.5.5.2 The deliberations of the Code Group are generally private so it can be difficult to estimate how they will react to new proposals. However, some illumination is shed by the long-running court proceedings regarding the tax regime proposed by Gibraltar in the early 2000s and which has been discussed in more detail in Section 7.3 above. Because State aid proceedings are processed through the European court system, the arguments advanced are publicly available and can provide some indication of the Commission's thinking on the interpretation of the Code of Conduct.

8.5.5.3 In light of that process, it is increasingly clear that the Code Group will look at all elements of a tax system as a whole in order to assess whether the cumulative effect of all taxes and charges in operation serves to advantage any one group of businesses. This argument was advanced during the Code Group's review of 0/10 during 2010/11.

8.5.5.4 In the Gibraltar case, the Gibraltar authorities had proposed to introduce a series of taxes and charges, including charges based on numbers of employees and a charge calculated on the property occupied by businesses. They would not apply if a company did not make a profit and were also subject to an upper cap if a company's profits exceeded a certain level.

8.5.5.5 The courts held that the connection between the charges payable and a company's profits meant that the charges were in fact taxes on profits. They also found that the cumulative effect of the charges was that only companies which carried on an active business in Gibraltar were subject to those charges. The tax system as a whole was therefore designed to give an advantage to offshore companies which did not employ staff or occupy premises. As a result, the regime did not comply with EU rules.

8.5.5.6 In order for a charge not to be considered to form part of the tax system therefore, it cannot have any features of a tax. It therefore cannot be linked to the level of a company's profits.

8.5.5.7 A charge should not be seen to support the tax system or to form part of the tax system. This can be achieved more easily if there is a policy objective behind the charge other than a desire to selectively increase general revenues, it is not linked to profitability and also if the level of the charge is low.

8.5.6 *Economic impact*

8.5.6.1 Each option considered has a different economic effect and these are discussed in more detail below. However, some common messages arise. Firstly, a charge which is not linked to profitability would be an absolute cost to business. If the level of the charge was to be set at such a rate as to raise significant amounts of revenue, there is a strong risk that the charge would affect business decisions.

8.5.6.2 The charge would be likely to be passed on to Jersey residents in the form of increased prices, thus creating inflationary pressures, or by depressing wages or affecting employment.

8.5.6.3 The introduction of a new fixed cost of carrying on business in Jersey could be a deterrent to new business in the Island.

8.5.6.4 Charges at low rates could be imposed without causing excessive damage, but the amount of revenue collected may not justify the additional investment required in order to establish and administer the charge.

8.5.6.5 A low charge may have less impact, but would not raise significant revenues.

8.5.7 *Responsibility for collection and enforcement*

8.5.7.1 As any kind of charge would not be a tax, consideration would have to be given to what agency would be most appropriate to collect it. The Taxes Office is not currently equipped to do so, and does not have the necessary knowledge to review property or employment issues at this time. It may be that another body should administer the charge, or that additional investment in the Taxes Office staff and software would be required in order to administer the charge appropriately.

8.5.8 *Specific types of charge considered:*

8.5.9 *Charge based on employment*

8.5.9.1 Charging companies a fee based on the numbers employed has been considered in the past, and one variation, the Regulation of Undertakings and Development charge (RUDL charge) was originally put forward as part of the potential package of measures to fill the "black hole" in public finances arising from the introduction of 0/10. Employers would be charged a fixed fee based on the number of staff they employ.

8.5.9.2 Any business intending to carry on an activity in Jersey must currently apply to be regulated under the Regulation of Undertakings Law 1973, and must also obtain consent to employ staff. In practice, companies tend to apply for a greater number of employment consents than they may have staff at any one time in order to ensure they have the flexibility to make hiring decisions without having to make a new application every time.

8.5.9.3 Currently, no fees are payable for housing and employment consents issued under the Regulation of Undertakings Law. However, this law is shortly to be replaced by the new Control of Housing and Work Law 201-, which is intended to help to control population levels and to secure housing and work for people with strong connections to Jersey. It is intended that the cost of administering that law will not be met by taxpayers as at present, but through the introduction of a "user pays" fee structure. In advance of the new law coming into force, the Chief Minister's Department has undertaken a review of what fees may be appropriate to charge in respect of the people who come to live and work in Jersey[21].

8.5.9.4 Although this work has yet to be concluded, as at the time of writing (September 2012), the proposals relating to employment are as follows:

- To charge businesses that employ "licensed" employees (equivalent to a 1(1)(j) housing consent under the current law) an annual fee of £200 per licensed employee

- No other changes are proposed for businesses on the basis that this could affect the profitability and viability of some businesses, especially those with smaller profit margins, or where additional costs could be passed on to the consumer resulting in inflation

- To charge individuals newly arriving in the Island a fee of £75, apart from those who are "entitled" (the equivalent of residentially qualified under the current

[21] "R.70/2012 Population Office: Consultation on fees – fees that may be levied under the new Control of Housing and Work (Jersey) Law 201-", Chief Minister's Department, presented to the States 7 June 2012. http://www.gov.je/Government/Consultations/Pages/ImmigrationControlsLevyingFees.aspx

rules) or "entitled to work" (equivalent to being locally qualified for work purposes through having 5 years of residence in the Island).

- To charge visiting contractors, traders and hawkers a licence fee that is to be determined.

8.5.9.5 The White Paper acknowledges that "very modest" charges are unlikely to have a material effect, which is also the finding of this review, although the merits of introducing a small charge and dealing with the administrative issues associated with collection of that charge are unclear.

8.5.9.6 Different ways of assessing the tax base exist. Employers could be charged on the basis of any of the following:

- **RUDL licences.** An early proposal was to charge companies based on the number of employment consents they held under the Regulation of Undertakings Law 1973. This could give rise to overpayments because as noted, companies may have permission to employ more individuals than they have staff at any point in time. Notwithstanding that, this basis of charging would become impractical following the coming into force of the Control of Housing and Work (Jersey) Law in the near future, as employers will no longer be required to obtain permission to employ locally qualified staff.

- **Headcount.** Under this basis, an employee who works for any length of time, even for one hour per week, would be counted. It does not appear equitable to charge a full fee in respect of a part-time employee. In addition, the nature of the retail sector is such that it relies heavily on the use of part-time staff, to reflect the cyclical nature of its trade. Over one third of the individuals employed in the retail sector are employed on a part-time basis. Assessing the charge on a headcount basis would unduly punish this sector for its working practices.

- **Full time equivalent (FTE) employees.** This basis requires employers to identify the number of full-time employees that could have been employed if the total number of hours worked by part-time employees had been worked by full-time employees as well. For example, if a business has a standard working week of 40 hours, two employees each working twenty hours per week would equal one full-time equivalent employee. This basis would appear to more accurately reflect the benefit obtained by an employer from its staff, and therefore would appear the most equitable basis for calculating an employment charge.

8.5.9.7 It is difficult to suggest that a charge based on employment is anything less than a tax on employment. This was one of the reasons why the original RUDL charge was not pursued. Particularly given the current unemployment rates in Jersey, it may be difficult to justify making it more expensive to hire staff. Care must also be taken that any fees charged do not undermine the States strategic priorities.

Example of revenues which could be raised through introducing a charge based on numbers of full-time equivalent employees in the retail sector

Approximately 4,300 full-time equivalent employees work in the retail sector. Assuming employment numbers did not change due to the introduction of the charge, a fee at the following rates would raise the following revenues.

The five largest employers in the retail sector employ an average of 464 FTE employees. The potential average revenue from these employers is as follows, although for those with significantly higher numbers of employees than the average, the cost to that company would be substantially higher.

Level of fee per employee	***Potential revenue raised (retail only)***	***Potential average revenue from 5 largest retail sector employers***
£50	*£215,000*	*£23,200*
£100	*£430,000*	*£46,400*
£500	*£2,150,000*	*£232,000*

8.5.10 *Charge based on property occupied*

8.5.10.1 Companies could be charged based on the amount of property they occupy. Under this type of charge, companies would be charged a fixed amount based on the area of property they occupied.

8.5.10.2 This would include:

- The retail space itself
- Any storage or administrative areas such as warehouses or offices
- Staff recreational spaces such as break rooms or designated smoking areas
- In the case of a property in multiple occupation, shared facilities such as staircases or entrance areas
- Car parking spaces for customer or staff use
- Any other land or premises controlled by the company.

8.5.10.3 For the most part, identifying the amount of space occupied by a company should not present undue difficulty as the space occupied by most businesses would not change often, although there may be a minor degree of complexity initially in establishing the correct treatment of shared areas.

8.5.10.4 Companies would be expected to provide evidence of the amount of property occupied. In most cases it would be expected that this would be reasonably straight forward and companies could provide copies of lease agreements or title deeds showing the area of the property. In cases of complexity or dispute, it may be necessary to engage an independent surveyor.

8.5.10.5 There would be some requirement for the Taxes Office (or whatever agency was responsible for enforcement of the charge) to ensure that the charge was being correctly declared, but this would not be considered to require excessive resource.

8.5.10.6 A charge based on floor space cannot take into account the value of that property. Retail companies in particular are limited in the extent to which they can reduce the size of their premises to reflect changes in business activity. The nature of much retail activity will dictate the size of premises required – a supermarket's requirements will be very different from those of a jeweller, for example and may be disproportionate to profitability.

8.5.10.7 The charge would therefore be a fixed cost to the companies affected, which would be likely to be passed on to Jersey residents in the form of increased prices or to employees through depressing employment or wages. The arguments against introducing a charge have been made above and are similar in this case.

8.5.10.8 No records are held which would allow any accurate assessment of the amount of revenue that could be collected from charging retailers a fee based on the amount of property occupied, as no authority in Jersey currently keeps that detailed level of information.

8.5.11 *Property value*

8.5.11.1 Companies could be charged a fee based on the value of the property they occupy. This would be similar to the current parish and Island rates system.

8.5.11.2 The economic impact would be similar to the other charges above.

8.5.11.3 No current valuation has been undertaken of Island properties for some time and this would present difficulties with assessing and collecting the charge. See the section on the deemed rental charge below for a further discussion of this.

8.5.11.4 However it is clear that this option would have a limited capacity to raise revenues. Doubling the non-domestic element of the Island rate for example would only raise approximately an additional £2 million, but since the intention would be to exclude the finance sector which is likely to occupy some of the more valuable property in the Island due to its concentration in St Helier, it is likely that the amount raised would be far lower.

8.5.11.5 A full review of the way in which land and property is taxed in Jersey is due to be undertaken over the next two to three years, which will review whether there are other ways to raise revenues in this area. See Section 9 for more details.

8.6 Restricting input GST recovery

8.6.1 GST is ultimately a tax on the end consumers of goods and services. Although tax is charged at each stage of production, suppliers of taxable goods and services are entitled to reclaim any GST they incur in the course of producing or acquiring the output they eventually sell on.

Example: Flow-through of GST for registered businesses

A GST-registered carpenter buys wood for £10,500 (£10,000 plus £500 GST) and uses it to build furniture which he then sells for £12,600 (£12,000 plus £600 GST). The amount of GST which he must pass on to the States is as follows:

Output tax (GST charged on sales)	*£600*
Input tax (GST paid on purchases)	*£500*
Net tax payable	***£100***

Ignoring other costs, the carpenter's profit is therefore:

Sales (excluding GST)	*£12,000*
Raw materials (excluding GST)	*£10,000*
Net profit	***£2,000***

8.6.2 GST has been designed in this way so as to minimise the inflationary effect of the tax. Because GST can be reclaimed at every stage of the production process, it does not become a cost of production. Thus, the tax only "sticks" when it reaches the ultimate consumer.

8.6.3 GST has also been designed so that domestic producers and suppliers are not at a competitive disadvantage when selling to the Jersey consumer, when compared to imported goods and services. GST at the same rate is payable when goods and services are supplied in Jersey, and when they are imported from overseas.

8.6.4 Not all businesses are entitled to recover the input tax they suffer and are therefore themselves treated as the end consumer for the purposes of GST. The GST "sticks" with that business and cannot be passed on any further. In practice, additional cost is rarely suffered by a business in the long term but passed on to customers through increased prices, to employees through lower wages and to shareholders as lower dividends or other returns on their investment.

8.6.5 A business which is not registered for GST cannot recover input tax. Nor can businesses which carry on certain types of activities and are prevented from recovering the input tax suffered in connection with that activity. These so-called "exempt" activities include the provision of insurance, postal services and many financial services activities.

8.6.6 A business which makes a mixture of exempt and taxable supplies may register for GST. If so, it may recover input tax connected with the taxable supplies only (subject to a de minimis), and none incurred in connection with its exempt activities.

8.6.7 Consideration has been given to extending this restriction of input tax recovery to all GST-registered companies, thereby effectively applying a charge to the business. A fixed percentage of all input tax related to taxable activities would be treated as irrecoverable.

Example: The impact of restricting recovery of input GST
A GST-registered carpenter buys wood for £10,500 (£10,000 plus £500 GST) and uses it to build furniture which he then sells for £12,600 (£12,000 plus £600 GST). Assuming he may recover 80% of input tax, the amount of GST which he must pass on to the States is as follows:

Output tax (GST charged on sales)	*£600*
Input tax recovered (GST paid on purchases) (£500 @ 80%)	*£400*
Net tax payable	***£200***
Of which:	
Irrecoverable input tax (£500 - £400)	***£100***
Ignoring other costs, the carpenter's profit is therefore:	
Sales (excluding GST)	*£12,000*
Raw materials (excluding GST)	*£10,000*
Irrecoverable input tax suffered	*£100*
Net profit	***£1,900***

In order to achieve the same level of profit, the carpenter must either increase his prices or reduce costs in other ways.

8.6.8 *Affected population*

8.6.8.1 Only businesses which are registered for GST are entitled to recover the GST which they incur in the course of their business. Non-registered businesses are treated in the same way as any other consumer, i.e. as the "end user" of the goods or services involved and unable to directly pass the tax on any further. In practice, non-registered businesses will typically seek to pass the cost of the GST they incur on to their customers through increased prices.

8.6.8.2 Businesses which are not registered for GST would not be directly affected by the proposal to limit the recovery of input tax. A business may be in this position either because it does not make taxable supplies and is therefore unable to register, or because the value of the supplies it does make is below the £300,000 threshold above which businesses are required to register, and it has not voluntarily registered.

8.6.8.3 However, non-registered businesses would see their cost base increase, as their own suppliers increased prices to reflect their reduced ability to recover GST. This increase would most likely be passed on to Jersey customers in the form of higher prices.

8.6.9 *Economic impact*

8.6.9.1 The impact of restricting the ability to recover input GST paid would be very similar to that of increasing the rate of GST. Jersey producers and suppliers would experience an increase in their cost of production. This increased cost would be passed on to customers, most likely in the form of increased prices. An increase in inflation would be likely, at least in the short term.

8.6.9.2 The second impact would be that suppliers which were able to provide a number of steps in the supply chain "in house" would be at a competitive advantage to suppliers who were not. Fewer links in a supply chain would reduce the opportunities for GST to be lost. Businesses which were not in a position to undertake more than one activity could therefore see their costs increasing more than those with the ability to perform multiple activities. This could also act as a disincentive to new businesses to enter the market, restricting competition.

8.6.10 *Impact on exporters and international competitiveness, including financial services providers*

8.6.10.1 Much of Jersey's economy, and in particular that part of it derived from the provision of financial services, is derived from non-residents. While designing the GST system, it was considered important to protect export industries from the effect of GST, so that Jersey's ability to sell goods and services outside the Island was unaffected. For most business sectors, this has been achieved through the inclusion in the GST (Jersey) Law 2007 of a provision which ensures that goods or services sold outside the Island are treated as taxable but are not subject to GST.

8.6.10.2 For the financial services industry, although many of their customers are outside Jersey, the services provided are generally provided in Jersey and often in respect of an entity which "belongs" (in the GST sense) in Jersey, such as a Jersey trust, company or foundation. In that circumstance, the general provision for exported services does not apply, because the immediate "user" of the services is in Jersey, albeit that the beneficial owner has no connection with the Island. The desire not to impose additional cost on exported services led to the development of the International Services Company (ISE) regime, whereby a company which is involved in the financial services sector may opt to pay a single annual fee in return for not having to pay GST on its purchases. This also reflects the desire that the financial services industry should contribute to overall GST revenues.

8.6.10.3 As ISEs do not suffer input GST, they would not be directly affected by the proposal to restrict recovery of GST, although their suppliers would be expected to increase their charges in response to their own input GST recovery being restricted.

8.6.10.4 ISEs can be divided into three broad categories. The overwhelming majority of ISEs (approximately 30,000 out of a total of 32,000) are clients of the financial services industry. These pay a relatively low fee (£200 per annum), which reflects the limited connection these companies have with the Island, although cumulatively this sector makes the greatest single contribution to overall ISE revenues. These clients form the basis of the financial services industry in the Island. This is an extremely competitive area, one in which Jersey has many competitors both close at hand and, increasingly, more geographically distant. It is important that tax measures do not inhibit the ability of Jersey businesses to compete in this key area. The level of the basic ISE fee has been set in an attempt to ensure that the fixed costs of being established in Jersey are set at a similar level, or just below our key competitors. One of the principal aims of this review, and of the 0/10 regime in general, was the protection of this vital part of Jersey's economy. It therefore follows that measures intended to raise additional revenues from non-financial services companies are not intended to apply to the client sector.

8.6.10.5 The second broad class of ISE are the providers of financial services such as banks, trust companies and fund administrators. Most of these companies are subject to income tax at the 10% rate applicable to financial services companies. Given that these companies are already contributing directly to Jersey's revenues, it is considered desirable that they would not be affected by an additional revenue-raising measure at this time. On that basis, the restriction of input GST would partly meet this goal, though the businesses could see an increase in the cost of their own purchases as their suppliers increased their costs to reflect the reduced recoverability of their own GST.

8.6.10.6 While exported services provided by the financial services industry would be somewhat protected from the impact of the overall restriction in input GST, through the operation of the ISE regime, other exporters of goods or services would not be in the same position. Restricting input tax recovery would make exports more expensive as their cost of production rose, which is not the intention of this review.

8.6.10.7 Increasing the tax burden on businesses, particularly export businesses, will make it more difficult to diversify the Island's economy away from its traditional financial services base.

8.6.10.8 It could be possible to provide that export activities were protected from the new measure, but this could become complicated to administer for both businesses and government.

Example: impact of protecting export activities from the GST recovery restriction

A farming business sells 80% of its produce to wholesalers in the UK and 20% to customers in Jersey. The business incurs costs of £25,000 (£25,000 plus £1,250 GST).

*Currently the business can recover the entire **£1,250** input tax as all of the supplies it makes are subject to GST (albeit at the rate of 0% in respect of the exported products).*

*If the percentage of input tax recovery is limited to 80%, the business can recover **£1,000** and the remaining **£250** is an additional cost.*

If the percentage of input tax recovery is limited to 80% but supplies made in Jersey are excluded, the business may recover:

Input GST attributable to supplies in Jersey only (£1,250 x 20%)	*£250*
Limited to 80% recovery	*£200*
Input GST attributable to exported supplies (£1,250 x 80%)	*£1,000*
Net GST recoverable	***£1,200***
Irrecoverable GST	***£50***

8.6.10.9 The third broad class of ISE is very much in the minority, making up less than a third of one percent of the total number of ISEs. These are non-financial services businesses which are predominantly or exclusively exporters of goods or services, or which only make supplies to other ISEs, or which act as passive asset holding vehicles and make no supplies. They may be used by providers of services to broader groups, such as back-office accounting and payroll functions. Although there may be some scope to increase the overall contribution to States' revenues from some of these companies, the ISE regime is not suited to achieving this. This does mean that companies which were not originally intended to benefit from the ISE regime will continue to benefit, while also being able to use the ISE regime to avoid making the additional contribution expected from other businesses. Although currently the number of companies availing of this treatment is low, there is a risk that restricting input tax recovery more generally will result in more companies which meet the qualifying criteria for ISE status obtaining it, and thereby reducing the efficacy of the reform.

8.6.10.10 This is considered to be a significant disadvantage to the introduction of a restriction on the recovery of input GST by registered businesses in general.

8.6.11 *Cost and complexity of administration*

8.6.11.1 Another argument against this system is that it would be complicated to set up and administer for both businesses and for the Taxes Office. The complexity of the VAT system is frequently flagged as the single biggest difficulty for small and medium businesses in the UK. The designers of Jersey's GST were keen to protect small businesses from this as much as possible, through setting the threshold above which a business must register for GST as one of the highest in the world (at £300,000 of taxable supplies in a year compared with £77,000 in the UK for 2012) and minimising the number of exemptions and reliefs available, all of which add complexity for the retailer or service provider.

8.6.11.2 Currently, the GST-registered business acts as the collection agent for GST on behalf of the Taxes Office. Although the onus of collecting the tax rests with the business, the liability is not that of the business (with the exception of partially exempt businesses registered for GST). There is little incentive for a business to incorrectly complete its GST return, but this position changes where a company is required to effectively assess how much tax it should pay on its own expenditure.

8.6.11.3 When GST was introduced, government was anxious to ensure that Jersey businesses should not be put at a competitive disadvantage. The concern was that businesses might choose to buy their goods and services from overseas rather than from Jersey providers, and thereby both avoid GST and put Jersey businesses at a competitive disadvantage. The GST (Jersey) Law 2007 therefore includes a provision which requires businesses to account for GST on the purchase of imported services as though the business had both provided and acquired the item.

Example: Impact of the self-supply rules

XYZ Limited, a GST-registered company which makes fully taxable supplies, buys online IT support services from a UK company for £20,000. Its GST account is as follows:

Notional output tax on sales (£20,000 @ 5%)	*£1,000*
Notional input tax on purchases (£20,000 @ 5%)	*£1,000*
Net tax payable	***£0***

8.6.11.4 For most GST-registered businesses, the self-supply rules (also referred to as the reverse charge rules) have little impact. A business that makes 100% taxable supplies may recover 100% of any input tax it suffers, so the entry is a booking keeping one only and does not have any financial implications.

8.6.11.5 Partially exempt businesses however may not recover all the input tax they suffer, and therefore these businesses must account for GST on the purchases they make outside Jersey. Under a partial recovery system of input tax, all GST-registered businesses would be in this position and their costs would increase in relation to imported purchases as well as though supplied in Jersey.

Example: Interaction of the partial recovery and self-supply rules
In the previous example, assuming that the rate of input tax recovery was limited to 90%, XYZ Limited's GST account would be as follows:

Notional output tax on sales (£20,000 @ 5%)	*£1,000*
Notional input tax on purchases (£20,000 @ 5%) restricted to 90%	*£900*
Net tax payable	***£100***

8.6.11.6 One of the aims of the GST regime is for it to be as simple as possible in order to minimise the effort involved in administering it. Creating another level of complication would undermine this principle. This is not, in itself, an insurmountable obstacle. However, once this step has been taken it will be very difficult to resist making further changes to the GST system in response to future calls to do so.

8.6.11.7 The rate of compliance with the GST rules is exceptionally high in Jersey, in part due to conscious decisions made during the design of the tax to ensure its simplicity in order to encourage compliance. However, restricting the ability of companies to recover input tax will act as a greater incentive to under- or miss-declare the true extent of activity. The Taxes Office would require more manpower and resources in order to police the regime effectively and to ensure compliance.

8.6.12 *GST as a medium for achieving social policy aims*

8.6.12.1 Finally, consideration must be given to the importance of maintaining the integrity and internal logic of the GST system. GST is a tax on the consumption of goods and services in Jersey. The States has consciously attempted not to use it for other purposes, such as for example achieving social aims – in the UK for example, some products are subject to lower rates of tax on the basis that reducing the tax rate might encourage consumers to make healthier choices, or that some choices are more expensive which will encourage consumers to make the more efficient choice. The extent to which the tax system is an efficient way of achieving social aims is at best debatable, and modern economic thinking suggests that it is both more equitable and more efficient to give targeted relief for example through the benefits system to those who would best benefit, rather than providing a blanket exemption across the board.

8.6.12.2 Although it is not the place of this report to debate the relative merits of charging GST on food, it is an example of where government policies differ. Everyone buying basic foodstuffs in the UK benefits from the fact that food is not subject to VAT there, regardless of whether they could afford to pay that VAT. In Jersey, the revenue earned through taxing food is passed to those who can least afford the tax through income support and the GST food allowance, and those who can pay do so.

8.6.12.3 This is relevant to a discussion of the relative merits of using the GST system to achieve another social aim, namely collecting more revenue from companies.

8.6.12.4 The extent to which the States is content to use the GST system to achieve an aim outside its original intention is one which must be settled by them alone. However, it is clear from the experience of other countries and other tax systems that once the internal logic of a tax regime has been muddied, it is inevitable that the regime will become more complicated to administer, that future changes will be more likely to have unintended consequences, and there will be a loss of flexibility.

8.6.13 *Revenue raising*

8.6.13.1 It is considered that it would be impossible to quantify the amount of revenue that could be raised from this measure, because the amount of revenue raised would depend to a large extent on the number of transactions in a supply chain before the good or service reached the end customer. Businesses that could do so would be encouraged to reduce the number of steps in their supply chains, and thereby reduce the input GST lost.

8.6.13.2 Estimates of revenue raising ability are also imprecise because, currently, fully taxable businesses are not required to disclose details of imported goods and services they acquire, as this does not affect their GST liability.

8.6.13.3 Additionally, it is not currently possible to identify what input tax is linked to supplies of exported goods and services, and therefore estimate how exempting that activity from the input tax restriction would affect revenues.

8.6.13.4 In any GST or VAT system, there is a certain amount of incentive for businesses not to declare all of the sales they make and to keep the tax they collect instead of paying it to the Taxes Office. Increasing the complexity of the GST system may increase the temptation for a minority of businesses to engage in abusive behaviour. With a reduction of recoverable GST on purchases but the expectation of full GST on sales, the inclination for businesses to omit purchases, and as a consequence sales from their records would increase. If unchecked, the effect of such behaviour would overall reduce the GST declared by these businesses and necessitate the deployment of additional resources and counter measures.

8.6.13.5 Finally, penalising GST-registered businesses in this way would be expected to reduce the number of businesses which have voluntarily registered for GST despite their taxable turnover being below the £300,000 compulsory registration threshold, and this would have an impact on revenue capacity.

8.6.14 *Compliance with the Code of Conduct*

8.6.14.1 The Code applies to taxes on business profits. GST is a tax on the consumption of goods and services and as such, would normally be expected to fall outside the scope of the Code. However, the Code does look at the effect of all taxes in a territory in order to establish whether the combined effect of the regime as a whole can be considered to give rise to harmful effects.

8.6.14.2 Currently, GST operates in a way which is very similar to the way that the UK VAT regime does. GST is not generally suffered by businesses, only those which carry on exempt or partially exempt activities, or those which are not registered for the tax. The role of business is technically that of agent of the Taxes Office, rather than taxpayer in its own right.

8.6.14.3 Restricting the ability of businesses to recover input GST would increase the range of companies which are subject to GST. If GST became a mechanism for raising revenues from companies, it could be subject to the same scrutiny as any other measure to raise taxes from companies.

8.6.14.4 Because the Code Group has never reviewed an indirect tax measure under the Code, it is difficult to say with any certainty what the result of a review would be.

8.7 Other measures previously advanced and reconsidered

8.7.1 *Tax on deemed rental income*

8.7.1.1 This measure was originally proposed by Jurat P.G. Blampied during the initial design process of 0/10. Recognising that companies which rent the properties through which they trade are making a tax contribution (in that the rental income is taxable at 20% in the hands of the landlords), the proposal was for companies which occupied properties which they themselves owned to be taxed on the notional rental value of those properties; i.e. the rent which they would have to pay in order to occupy the premises.

8.7.1.2 At the time when the deemed rental tax was being considered, the deemed distribution rules were also in force, meaning that Jersey resident individuals who owned shares in Jersey companies would be taxed on undistributed profits of the company. It was considered that this gave an unfair advantage to companies owned by non-residents, as their shareholders would not be taxed on profits as they arose, but only when they were distributed and then according to the rules in force in their home jurisdictions.

8.7.1.3 The deviser of the deemed rental tax considered that taxing companies owned by non-residents would remove some of the inequity caused by the operation of the deemed distribution rules, because some companies owned by non-residents would contribute directly to Jersey's company tax revenues.

8.7.1.4 In light of concerns that the deemed rental tax could be economically damaging, it was decided that the maximum amount of tax payable by any company in respect of any one year of assessment would be capped at the level of the company's profits in the same period.

8.7.1.5 The proposal was considered in some detail in the early and mid-2000's. Economic analysis was undertaken by Oxera[22], a public consultation exercise was undertaken, draft legislation was lodged with the States and a review was undertaken by the Corporate Services Scrutiny Panel. In part due to the findings of the Scrutiny Panel, a decision was taken not to pursue the law at that time. As a result, the draft legislation which would have created the deemed rental tax was withdrawn and not debated by the States.

8.7.1.6 The findings of the Scrutiny panel[23], together with the response of the Minister for Treasury and Resources[24] were as follows:

[22] "What is the economic and distributional impact of an owner-occupied immovable property tax?", Oxera, 22 May 2007

[23] "SR2/2009: Deemed rent (P. 161/2008)", Corporate Services Scrutiny Panel, 23 March 2009, http://www.scrutiny.gov.je/Pages/Review.aspx?ReviewId=67

[24] "Corporate Services Scrutiny Panel: Deemed rent (P.161/2008) (S.R.2/2009) – Response of the Minister for Treasury and Resources", 13 July 2009

No.	Scrutiny panel key finding	Original ministerial response
1.	Proposal increases administrative burden on some companies.	This is accepted. The companies affected will have to obtain valuations on a three yearly basis and submit these to the Comptroller of Income Tax, along with trading accounts, although that is balanced by the fact that they will no longer pay tax at 20% on these trading profits.
2.	The Department appears not to have a robust record of companies to apply the 'Deemed Rent'.	This is also accepted. There are no requirements for the companies that will be affected by the 'Deemed Rent' to currently make a formal return of the properties they own in Jersey to the Department. However, preliminary indications of the properties owned by these companies was obtained through some research undertaken at St. Helier Town Hall.
3.	Parish Rates are unsuitable to obtain ownership information.	It is agreed that the Parish Rates records are out of date insofar as obtaining current and up to date records of rental market value are concerned. They also appear to be unreliable in determining what properties are actually owned in Jersey by these non-finance non Jersey owned companies.
4.	There have been insufficiently robust investigations to establish yield.	This is an unjust criticism as there are no reliable records available to the Department to establish yield. Indeed, the Department has no legal means to obtain evidence as to which of the companies that may be affected owns what properties in Jersey.
5.	Without a robust estimate of the likely yield, we do not know how far the legislation goes to satisfy equity objectives between local companies and foreign companies. The legislation will also create new inequities between foreign companies themselves but without evidence as to what proportion own their own premises we do not know how widespread those inequities will be.	This is accepted.
6.	The difficulty in obtaining an	This is accepted as there are no

	offset against UK tax could be a significant disincentive to trading in Jersey. The Treasury has not obtained evidence of how many companies would have to reorganise their groups to obtain an offset, or what the cost of doing so would be.	means available to the Department to obtain this evidence.
7.	Anti-avoidance measures are contained within the draft law but several commentators still believe that it will be possible to avoid the tax.	Whilst there are strong anti-avoidance provisions in the Law it is the considered opinion of the Comptroller of Income Tax that professionals and others will challenge him and that there is likely to be considerable administrative and compliance burdens on the Income Tax office in arguing and attempting to rebuff these challenges. On balance, it is likely that the overall cost of compliance will be considerable and may outweigh the additional tax collected.
8.	Evasion of tax is a criminal activity dealt with by the Income Tax (Jersey) Law.	This is correct. Tax evasion now carries a maximum prison sentence of 15 years.
[Key findings 9 – 12 relate to a separate matter and have not been reproduced]		
13.	There are manpower and cost implications to this proposal.	This is accepted.
14.	There is no Ministerial confidence in this proposition.	It is accepted that there are concerns about this proposition.

8.7.1.7 As part of this exercise, the original deemed rental tax proposals have been re-examined in light of the developed understanding of the criteria of the EU Code of Conduct Group in that time.

8.7.1.8 The following issues were identified:

8.7.1.9 A non-Jersey resident shareholder (company or individual) would be unlikely to be able to obtain relief for tax on deemed rental income paid in Jersey when they received the income in their home territory. The tax payable in Jersey would therefore become an additional cost of doing business in the Island.

8.7.1.10 In order to mitigate the economic damage from introducing a deemed rental tax, it was proposed that the level of the tax should be linked to profitability. A company would pay based on the lower of its deemed rental income or its profitability, so if a company had deemed rental income of £50,000 and profits of £30,000, it would pay its deemed rental tax based on the profits of £30,000. A company making a loss would not be liable to the tax. Gibraltar had announced a similar tax regime in the early 2000s as part of a package of measures intended to respond to criticisms of its company tax regime by the EU Code Group. This was challenged by the European Commission albeit under the State aid rules rather than through the Code Group process. A final ruling has now been handed down by the European Court of Justice[25] which makes it clear that a tax on property occupation which is linked to profitability is a tax on profits. This is relevant because increasing the numbers of companies subject to tax in Jersey will raise questions over whether 0% is the general rate of tax applied in the Island. This in turn makes it more difficult to identify the appropriate rate of tax and defend the basis on which the Island carries out tax reform.

8.7.1.11 One concern raised when the deemed rental tax was first proposed, and identified as such by the Scrutiny review in 2009, was that the deemed rental tax would not be considered to be an "equivalent tax" by the UK tax authorities. Double tax relief for overseas tax suffered is only given by the UK authorities where the tax is considered to be equivalent to a UK tax on income. Despite linking the tax to profits, it is unlikely that the deemed rental tax would be considered to be sufficiently similar to a tax on profits to be acceptable for UK purposes.

8.7.1.12 The economic advice obtained from when the deemed rental provisions were being developed indicated that this lack of creditability meant that the deemed rental tax would be an absolute cost for companies looking to do business in Jersey. This risked damaging Jersey's competitiveness and ability to attract new business.

8.7.1.13 As previously mentioned, since the original law was lodged in 2009, the UK has changed the way in which it taxes UK companies on profits arising overseas. This means that in certain circumstances a UK company will no longer pay tax in the UK on dividends it receives from an overseas subsidiary, or on profits earned by a branch in another jurisdiction. The position for individuals is unchanged, so a UK resident individual who owns shares in a Jersey company will not receive any relief for overseas tax suffered and will be liable to tax in full on any distributions received.

8.7.1.14 Despite the change in the UK practice regarding overseas profits, the economic analysis that the deemed rental tax would be economically damaging remains true. It would add an additional layer of cost to operating in Jersey which has the potential to deter new investment, and to act as a brake on existing businesses, although less so than a charge not linked to profits.

8.7.1.15 Discriminating between local and non-locally owned companies could affect inward investment.

8.7.1.16 In addition, many of the original concerns with the deemed rental proposal continue to be relevant.

8.7.1.17 It was originally intended that the deemed rental provisions should only apply to companies not subject to tax at 10% as financial services companies or 20% as utility companies. This was meant to ensure that companies which were already paying a positive rate of tax on their profits would not be subject to additional tax,

[25] Joined Cases C-109/09 P and C-107/09 P; European Commission v Government of Gibraltar, United Kingdom of Great Britain and Northern Ireland, Kingdom of Spain, Kingdom of Spain v European Commission, Government of Gibraltar, United Kingdom of Great Britain and Northern Ireland [unreported decision of the ECJ, 23 November 2011]. The judgement may be accessed at: http://curia.europa.eu/juris/document/document.jsf?docid=114241&mode=req&pageIndex=1&dir=&occ=firstpart=1&text=&doclang=EN&cid=504575

and in particular, additional tax not based on profitability. The deemed rental tax was only based on profitability to the extent that the company's profits were lower than the tax; where profits were higher, the deemed rental tax would become a fixed cost of operation for that business.

8.7.1.18 Concerns were raised regarding the method of establishing an appropriate tax base for the deemed rental tax, i.e. identifying the market rental value of an owner-occupied property. There is currently no central register of property values in Jersey. The closest to this is the information held by each of the parishes and used by them to set and collect rates annually. However, this information is not frequently updated and valuations are performed by volunteer rates assessors who, while exceedingly conscientious, are not professional valuers and did not welcome the responsibility of establishing notional rental values for the purposes of calculating the deemed rental tax. In order to facilitate this, the original deemed rental proposition proposed that owner/occupiers should be required to obtain a professional valuation of their property before the deemed rental tax came into effect, and then at intervals of three years obtain an updated valuation.

8.7.1.19 In turn, industry representatives were concerned that the cost of obtaining professional valuations every three years would be excessive. Companies would also be required to prepare and submit calculations of their taxable income because of the connection with the company's profitability. This in turn would require resourcing from the Taxes Office to review and potentially investigate the tax disclosure made. The Scrutiny report suggested that the amount of effort involved would be disproportionate to the amount of revenue likely to be raised from the measure.

8.7.1.20 The amount of revenue likely to be raised through the adoption of this measure continues to be difficult to quantify, as insufficient records of property ownership are held by the States. Although some details are held by the parishes in order to assess rates, it is acknowledged that these are not guaranteed to be up to date.

8.7.1.21 In conclusion, many of the points raised by the Scrutiny panel in its review in 2008 remain valid today, particularly those relating to the difficulties in assessing and collecting the tax. Since then, other factors have become clearer which make this option less attractive. The economic impact of imposing a tax based on property values would be likely to translate to a reduction in property prices in the long term, and in the shorter term to a reduction in wages or employment, or increased prices for consumers. For all of these reasons, a tax based on deemed rental values is not recommended at this time.

8.7.2 *Community charge*

8.7.2.1 Some form of "community charge" has been proposed in the past. This would be a tax on the profits of companies which employ staff and occupy premises in Jersey, and could be designed in such a way that the charge only applied to companies with a certain level of profits, staff or premises.

8.7.2.2 Although described as a charge, this would be considered a tax as it would be calculated based on the amount of a company's profits. Introducing another tax on companies to run alongside 0/10 would be unlikely to be acceptable to the EU Code Group.

8.7.2.3 The 0/10 regime has been designed in such a way that the general rate of tax paid by the majority of companies in the Island is 0%. This includes the majority of companies carrying on active businesses here. If some of these companies were to be subject to a higher rate of tax due to the operation of the community charge, it would become more difficult to defend 0% as the general rate.

9. PROPERTY TAXES

9.1 The principles

9.1.1 In recent years, as tax rates have generally fallen, focus has moved away from taxing income in favour of taxing consumption. In that environment, renewed consideration has been given to the options for raising revenues through the taxation of land and property.

9.1.2 On the positive side, it is considered difficult to avoid tax on land, as unlike other assets, it is not possible to remove land from a jurisdiction in order to avoid paying tax on it there.

9.1.3 There is also an argument that land represents a scarce resource, and charging taxes on it is another form of consumption tax.

9.1.4 On the other hand, a tax based on the value of an asset instead of income cannot reflect the ability of the owners to pay the tax. There are many reasons why a particular taxpayer may have a valuable asset but without a substantial income

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9.1.5 The introduction of taxes or charges based on property usage is also likely to affect the value of those properties, at least in the short term. This is discussed in more detail in the section on introducing a charge based on property value or usage in Section 8 above.

9.2 The Mirlees Review

9.2.1 In 2011, the Institute for Fiscal Studies published the results of a long-running review into the UK tax system, known as the Mirlees Review after its chair, the economist Professor Sir James Mirlees.

9.2.2 The Mirlees Review considered the characteristics that would make for a good tax system in an open economy in the twenty-first century. It also made suggestions for how the British tax system in particular might be reformed to move closer to the ideal. The intention of the review was to examine the tax system more broadly and from a global perspective as well as a British one[26].

9.2.3 Mirlees considered that the question of the taxation of land should be re-examined. He felt that there were economic arguments in favour:

- *Taxing land ownership is equivalent to taxing an economic rent — to do so does not discourage any desirable activity.*

- *Land is not a produced input; its supply is fixed and cannot be affected by the introduction of a tax. With the same amount of land available, people would not be willing to pay any more for it than before, so (the present value of) a land value tax (LVT) would be reflected one-for-one in a lower price of land.*

- *Owners of land on the day such a tax is announced would suffer a windfall loss as the value of their asset was reduced. But this windfall loss is the only effect of the tax: the incentive to buy, develop, or use land would not change. Economic activity that was previously worthwhile remains worthwhile.*

[26] http://www.ifs.org.uk/mirrleesReview/about

- *Moreover, a tax on land value would also capture the benefits accruing to landowners from external developments rather than their own efforts*[27].

9.3 Property usage in Jersey

9.3.1 Property is lightly taxed in Jersey. Tax is due on income from property ownership and property is subject to domestic and commercial rates. Given the focus towards consumption tax and the relative efficiency of property tax, further work will be done on this area.

9.3.2 The review will focus on the different types of property use and exploitation in Jersey.

9.3.3 Rental activity

9.3.3.1 Income earned from renting out property in Jersey is subject to tax at 20%, regardless of whether the landlord is an individual or a company, resident or non-resident.

9.3.3.2 However, there are a number of reliefs that are available to landlords, which can be used to reduce the tax liability arising. These reliefs include the ability to claim a deduction for interest paid in connection with loans taken out to purchase the property, and capital allowances on fixed assets provided with the property.

9.3.3.3 It is intended to undertake a review of the scale of the reliefs available to landlords, in particular in relation to the availability of interest relief as it is felt that there is an opportunity for landlords, particularly corporate landlords, to claim relief for excessive amounts of interest paid.

9.3.3.4 This review is intended to ensure that landlords pay the tax that is properly due.

9.3.4 Property development activity

9.3.4.1 Profits from the commercial development of land and buildings in Jersey is taxed at the rate of 20%. This rate applies equally to companies and to individuals.

9.3.4.2 However, where a land owner does not directly develop the property, but merely sells it for development, tax does not always arise. This is because Jersey does not currently operate a system of taxing capital gains, i.e. gains that arise from the increase in value of an asset. If a farmer for example sells a field for development, then in some circumstances, the gain on the increase in the value of that land may not be subject to income tax.

9.3.4.3 As committed in the response to P. 147/2011 “Land development tax or equivalent mechanisms”, further work is to be done on considering ways of taxing landowners on increases in value of land sold for development purposes.

9.3.4.4 However, merely taxing landowners on the increase in the potential value of their property – before it is sold – could put landowners in a difficult financial position if they do not have the funds to pay a tax charge on an unrealised gain.

9.3.4.5 An initial review undertaken by Oxera in 2008 indicated that the extra cost of the tax would be likely to be borne by landowners and not passed on in the form of

[27] http://www.ifs.org.uk/mirrleesReview/design

increased property prices. However, other factors will also influence the eventual price of new properties released to the public.

9.3.5 Property usage

9.3.5.1 There may be scope for taxes on property usage. This is discussed in more detail in Section 8.

9.3.5.2 Since the taxation of property is developing, innovative ways of taxing property may also emerge. These will also be considered.

9.4 The planned review

9.4.1 A review of this nature must be undertaken with care. Oxera pointed out in 2008 that it would be important that if any changes were introduced, it would be important that landowners considered they were credible and likely to be in place for a long time, as otherwise the market in properties could be affected as landowners delayed making property available for sale.

9.4.2 Any changes will be made following full consultation.

9.4.3 This review has commenced and will take time to complete. The full review will tax 2 – 3 years although the initial focus will be on reviewing the relief for interest paid by landlords, measures for which will be included in the 2014 Budget. Given that any property tax or charge will effect the economy to some extent, any changes should only be made when the economic conditions are right.

10. KEY FINDINGS

10.1 Improved fairness of the Jersey tax system for shareholders

10.1.1 Removing the shareholder taxation rules (deemed distribution and full attribution) has removed much of the perceived inequity in the current tax regime. Now, all shareholders of Jersey companies are not taxed on the profits of the company unless and until they are distributed. Indeed, shareholders resident in other jurisdictions with higher tax rates than Jersey may pay more tax on profits distributed from Jersey companies, depending on how they are taxed on dividends received from overseas companies.

Key finding 1: Efforts should be made to address the misconception that there is inequity for companies owned by Jersey residents and their shareholders in the current tax regime.

10.2 The importance of the financial services industry to Jersey

10.2.1 The financial services industry is key to Jersey's economic well-being. The 0/10 tax regime was developed to support the industry, in particular by providing the ability to offer a tax neutral vehicle in Jersey for clients of the finance industry.

10.2.2 Protecting the position of the financial services industry is key to Jersey's on-going economic well-being. The responses to the Business Tax Review undertaken in 2010 identified the 0/10 company tax regime as important to the industry and as such, it should be continued and protected into the future.

Key finding 2: No action should be taken which could jeopardise the current company tax regime.

10.3 Data availability

10.3.1 Insufficient information is currently available regarding the profitability of Jersey companies. This makes it difficult to assess how much revenue would be raised if it were decided to extend the scope of the 10% or 20% tax bands to particular industries.

10.3.2 In addition, it is important that Jersey can demonstrate that 0% is the general rate of company tax, paid by the majority of companies in Jersey and on the majority of their profits. Currently, the information available on the profits earned by many clients of financial services industry is limited, which may make it more difficult to demonstrate that 0% is the general rate of tax, were the scope of the 10% or 20% bands to be increased.

Key finding 3: More information should be collected from companies in Jersey to allow their profits to be accurately known. A White Paper on methods to improve the collection of this information is being issued along with this report, which invites comments on the best way to ensure the necessary information is collected.

10.4 Summary of the tax and economic impact of introducing a tax or charge, or limiting recovery of GST for non-financial services companies

10.4.1 The independent economic advice is that seeking to increase revenues from companies owned by non-residents will be an increase in the cost of doing business in Jersey. In industries such as the retail sector, where the majority of the largest companies are owned by non-residents, this increase will be passed on to Jersey residents and not absorbed by the companies themselves.

10.4.3 Therefore, any move to increase costs for non-locally owned companies will see an increase in inflation, a reduction in wages for staff employed in the relevant sectors or a reduction in overall employment, or a combination of all three. Measures which make it more difficult for new businesses to enter the Jersey market will negatively affect the Island's attempt to diversify its economy away from its traditional financial services activities.

10.4.4 In many respects, increasing tax revenues from the retail sector in particular would have a similar impact on the consumer as increasing the rate of GST.

10.4.5 Since the start of the global economic downturn, Jersey residents have seen their real incomes squeezed, as taxes and prices have risen but wages have not kept pace with inflation[28]. In the short term, this seems unlikely to reverse[29].

Key finding 4: While there is no immediate need to increase States revenues, tax measures should not be introduced which are likely to negatively affect Jersey residents.

10.4.6 Extending the scope of the 10% or 20% bands

10.4.6.1 Introducing a profits tax on all businesses with a presence on the island (such as all retail, restaurants, hotels and other non-financial service providers) would likely result in 0/10 being considered harmful by the Code Group as it may be argued that zero is not the general rate of tax, particularly in light of the EU Commission's comments in their review of 0/10 in 2010/11.

10.4.6.2 It could be possible to expand the scope slightly of the 10% or 20% tax band without jeopardising the Code compliance of 0/10. However, it would be likely that only one industry could be added, but only if there was sufficient data to support the fact that 0% remained the general rate of company tax. Identifying that one sector in the tax law would be likely to cause complexity and uncertainty for business and the tax administration.

10.4.6.3 The additional tax revenues raised from this would be likely to be relatively minor, as the most profitable companies in Jersey – financial services companies – already pay income tax at 10%. As an illustration, taxing the retail sector at 10% may raise up to £5 million per annum although in the current economic climate it is likely to be significantly less.

[28] See for example the most recent "Index of Average Earnings 2012", August 2012, States of Jersey Statistics Unit (http://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=796) which says that earnings have risen at a lower rate than prices for the third consecutive year.
[29] "Economic Outlook August 2012", August 2012, States of Jersey Economics Unit (http://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=796)

10.4.6.4 From an economic perspective, taxing profits is generally considered not to be as economically damaging as imposing charges or the other options explored. However, since a change in the UK treatment of profits earned overseas, many UK-owned groups will no longer pay UK corporation tax on profits distributed by their Jersey subsidiaries. This means that any tax payable in Jersey would be an additional cost of doing business in the Island. It is likely that this additional cost would be recouped from Jersey residents, particularly in sectors where the majority of companies are owned outside the Island, such as retail.

10.4.6.5 Changing the Jersey tax system again, so soon after the introduction of 0/10 and the uncertainty caused by the EU Code Group's review of 0/10, could send worrying signals to the wider business community regarding the stability of Jersey's tax regime. This in turn could undermine Jersey's attempts to diversify its economy away from its current degree of reliance on financial services activities. Businesses which cannot be certain what tax rate will apply to them may find this a disincentive to invest in the Island.

10.4.7 Introducing a charge based on employment or property occupied

10.4.7.1 Introducing a charge which is linked to profitability would be likely to fall foul of the Code as it could be considered a tax rather than a charge and hence destroy the concept that 0% is the general rate of tax.

10.4.7.2 Any measure that might raise any significant level of taxes/revenues would need to be set at such a level as to impose unwelcome additional cost on new businesses and would create uncertainty about the future tax treatment of businesses in the Island. This is counter to the inward investment/economic growth strategy being formulated by EDD and supported by the Council of Ministers.

10.4.7.3 While a small charge would be less damaging, the amount of revenue raised as a result would be low and may not sufficiently outweigh the costs of setting up and administering the charge.

10.4.7.4 From an economic perspective, levying charges is more economically distortive because it can deter new entrants into a market (and hence depress competition) and encourages businesses not to invest in the item which attracts the charge. For example, if a charge was based on the numbers employed, businesses would be more reluctant to increase the number of employees.

10.4.7.5 Measures that discriminated between local and non-locally owned companies could deter inward investment.

10.4.8 Restricting input GST recovery for all companies

10.4.8.1 Restricting companies' ability to recover some of the GST they pay on their purchases would increase the effective rate of GST in the Island.

10.4.8.2 This would have a similar effect to increasing the rate of GST, in that the increased cost of production would be likely to be passed on to customers in Jersey through increased costs. This would make imported goods and services more attractive, to the possible detriment of Jersey businesses.

10.4.8.3 The complexity of administering this system would make it the least desirable of the three main options explored.

Key finding 5: There is no "perfect" solution to increasing revenues from non-locally owned companies that will not make Jersey a more expensive place in which to do business. This additional cost would be passed on to Jersey residents in the form of increased prices (inflation) or through reduced wages or employment. Discriminating between companies owned by Jersey and non-Jersey shareholders could deter inward investment. In the current economic climate, measures which would increase prices or reduce wages or employment, or stall economic growth, should not be adopted.

10.5 Property taxes

10.5.1 Property is lightly taxed in Jersey. Recent thinking in tax policy has focussed on ways of taxing property, which is in line with the current move towards greater taxes on consumption and lower taxes on income and profits. Property taxes are also considered relatively efficient from an economic perspective, in that they may distort people's activity less than other types of tax.

10.5.2 A review of property taxes should be undertaken with care. Oxera pointed out in 2008 that if any changes were introduced, it would be important that landowners considered they were credible and likely to be in place for a long time, as otherwise the market in properties could be affected as landowners delayed making property available for sale.

Key finding 6: In future, should the economic climate improve sufficiently, consideration may be given to extending the property tax regime. Property in Jersey is taxed lightly, in particular through commercial rates. A review should be undertaken to review the scope to change the way property is taxed more generally. As an initial step, it is considered that there is an opportunity to look at the relief that landlords, and in particular non-resident landlords, claim in respect of interest, in order to ensure that the owners of property in Jersey pay the tax properly due.

10.6 International developments

10.6.1 Jersey does not operate in a vacuum, and its tax policies reflect that. International standards in taxation will continue to develop in the future, some of which may affect the Island and its policies.

10.6.2 Jersey could also be affected by changes made by its key competitors which could affect Jersey's international competitive position.

Key finding 7: Jersey should continue to monitor developments in international standards in taxation as well as changes in its key competitors in order to ensure that its tax system remains competitive.

APPENDICES – SUPPORTING RESEARCH

VII. Medium Term Financial Plan, Long Term Tax Policy – July 2012

VIII. Facing Up to the Future – 2004

IX. Code Group assessment findings –1999

X. Comparative analysis of the Crown Dependencies company tax regimes

XI. Oxera report: The economic impact of specific potential changes to the taxation of, or application of charges to, specific activities in Jersey – October 2012

XII. Bibliography

Appendix I

Medium Term Financial Plan, Long Term Tax Policy
July 2012

Appendix Eleven - Long Term Tax Policy for Jersey

Introduction

1453. The Tax Policy Unit has been asked to consider Jersey's long-term tax policy. In this case, "long-term" is taken to mean longer than five years. Advice from the Fiscal Policy Panel is that fiscal policy needs to be focussed on the medium term. The same should apply to tax policy, which forms part of the overall fiscal policy.

1454. It is difficult to be certain about Jersey's long term economic needs and hence tax policy, particularly in such an unstable economic environment. Further, tax policy should be designed to support rather than drive economic and political policy. This paper is therefore based on the current economic and political desires, further details of which are set out in the background section.

1455. It is not the place of a long-term tax policy in itself to be highly prescriptive about the types and proportions of taxes applied. Even in less economically uncertain times, it would be impossible to be able to determine precisely what taxes Jersey should apply in a decade's time. As such, it would be unhelpful to stipulate, for example, the percentage of States revenues which should come from different types of taxes. The policy should set out the principles and objectives on which future tax reform, if any, should be based to achieve the economic and political aims. The policy must also be flexible enough to deal with unexpected future changes.

1456. This paper looks at the recommended principles and objectives of Jersey's long term tax policy, as shaped by economic and political policy objectives. It also goes further to recommend the way forward based on those principles and objectives.

Background

1457. Jersey is a small island economy on the periphery of a large economic power, the European Union. Traditional industries have been agriculture and tourism, and since the mid-1960s, the provision of financial services. As both agriculture and tourism are relatively low value added, successive States have decided that the Island's economic well-being is best served by focussing resources on the financial services industry, on the basis that this is one of the few industries which is high value added with a low requirement for geographical resources. As such, it is suited to a small island with a small population.

1458. In the immediate future it seems unlikely that the balance of industries in the Island will shift dramatically away from finance as it currently exists. This is of course barring any external events which caused the industry to leave, but in such case the Island's economic base would be so fundamentally altered as to render current policy obsolete.

1459. Although Jersey's tax system was, until the zero/ten reform, stable and unchanged over a long period of time, this is unusual. Economic theory on tax has evolved over time – for example the gradual, but inexorable, move away from taxes on income only, to taxes on income and capital including inheritance and capital gains taxes (direct taxes). More recently, globally, states are moving away from a reliance on taxes on income and capital towards taxes on consumption (value added taxes such as GST) and immovable resources (such as taxes on land), known as indirect taxes. Tax bases are broadening rather than narrowing and having a mix of direct and indirect taxes is now considered to make revenues more stable.

1460. Indirect taxes are generally considered to be more efficient for a number of reasons:

- *Difficulty of avoidance. Indirect taxes are more difficult to avoid than taxes on income because they are charged at the point of transaction. There is no onus on the taxpayer to record and report the taxable event.*
- *Ease of collection. Revenue is assessed on and collected by a small number of businesses and not from the population as a whole. There is no onus on the taxpayer to record and report the taxable event.*
- *Broad tax base. Indirect taxes are paid by the whole population, unlike other taxes. As such, rates can be lower because they are more broadly applied. However, where territories exempt a wide range of goods or services, then the tax base shrinks and the rate applied may have to increase in order to raise sufficient revenues.*
- *Less distortionary. Indirect taxes are considered to be less distorting than direct taxes in that they have less of an impact on taxpayer behaviour.*

1461. However, indirect taxes may be considered by some to be less equitable than direct taxes, as those on lower incomes may spend more of their annual income on taxed items and may pay a similar or slightly greater proportion of that income in tax than those on higher incomes. Indirect taxes tend not to contain the progressive element that is contained in most income tax structures. This was a factor Jersey was aware of when introducing GST and as a result the States took steps to minimise the impact on those on lower incomes through increases in Income Support and the introduction of the GST Food Bonus for those on lower incomes but not in receipt of Income Support.

1462. Recent reforms in Jersey have changed the mix of taxes away from reliance on direct taxes following the introduction of GST. Given the generally accepted view that a broad based tax regime which includes a mix of direct and indirect taxes is more efficient, stable and sustainable, GST, income tax and social security are likely to remain key to Jersey's revenues into the future. It should be noted that not all taxes in every category are necessarily required or desirable for every jurisdiction and economic model.

What is tax for?

1463. At its most basic, the purpose of tax is to raise sufficient revenues to meet government spending commitments. (A discussion of the relative merits of meeting spending commitments through tax, borrowing or disposal of capital assets is outside the scope of this paper, as is any discussion of how government should spend its revenues.) Governments of developed countries provide policing, a legal system, health, education, basic infrastructure such as roads and sewerage systems, social housing, a social welfare system etc. Different governments will have different priorities but some or all of the above will typically be provided.

1464. Taxes can also be used for other purposes:

- *Fostering a sense of communal identity. There is an argument that making a financial contribution to the society in which one lives helps individuals to feel more connected to that community, and to hold their government to account.*
- *Redistributing wealth. Taxation is a basic method of taking money from the wealthy and distributing it to the less-well off, whether directly through payments of pensions, child allowances, income support etc, or indirectly through the provision of public services which the wealthier tend to make less use of, such as public health services.*
- *Influencing taxpayer behaviour. Taxes can be used to encourage certain actions or discourage undesirable actions. Examples are duties on health-damaging products such as alcohol or tobacco products or environmental taxes. However, tax is a blunt*

instrument and its effects are unpredictable. Higher taxes which make, for example, imported goods more expensive than their domestically-produced counterparts can make the imports appear of a higher cachet and therefore more desirable.

- *Discouraging avoidance of other taxes. Some taxes are introduced not so much to raise revenue as to discourage avoidance of others. For example, Capital Gains Tax was introduced in the UK to discourage taxpayers from avoiding income tax by converting taxable income into untaxed capital, although in itself raises comparatively little revenue.*
- *Supporting government fiscal policy. Tax policy does have a role, in conjunction with other fiscal policies, in helping getting the balance right for the economic conditions, support counter cyclical policy and possibly to strengthen automatic fiscal stabilisers.*
- *Supporting government social policy. Tax policy can have a role in supporting social policy such as through the provision of tax reliefs and incentives. As with influencing tax behaviour, this can be a blunt instrument unless properly and effectively targeted.*

Jersey's long term economic and political policies

1465. As a small island economy, Jersey's tax policy should support the economic and political aims of the States.

1466. There is no single comprehensive statement which sets out the long term economic and political aims and so these have had to be drawn from a number of sources. Reference has been made to the following in determining the current long term economic and political aims:

- *Recommendations of the Fiscal Policy Panel on Jersey's fiscal policy.*
- *The States approved Strategic Plan 2012 entitled 'Inspiring Confidence in Jersey's Future'.*
- *The draft States Economic Growth and Diversification Strategy.*
- *The States decisions in recent months and years on tax reform including:*
  - *Introduction and defence of the zero/ten tax regime for companies.*
  - *Introduction and retention of a low and broad GST regime, with limited exemptions but with direct measures to protect those on the lowest incomes.*
  - *Introduction of '20 means 20' ensuring those on the highest incomes pay tax at the highest rate*
  - *Retention of the 20% personal tax rate.*
  - *Introduction of a new tax regime to encourage inward migration of wealthy individuals and their businesses.*
  - *Introduction of enhanced child care relief to support working families.*
  - *A desire, as indicated in States debates, to modernise and simplify the personal tax regime, for example through independent taxation and other measures described in recent Budget Statements.*
- *The outcomes of the Fiscal Strategy and Business Tax reviews undertaken in 2010.*
- *Jersey's commitment to comply with international standards on tax matters.*
- *Current financial forecasts.*

Jersey's tax policy must support these aims.

1467. The policy objectives indicated by each of these sources are summarised below.

1468. The key message from the Fiscal Policy Panel relating to tax policy, based on the current state of the Island's finances and the economic climate, is that any change which permanently reduces taxation or increases spending should be accompanied by a compensating measure.

1469. The most urgent priority of the Strategic Plan is getting people into work. This will require economic growth to assist job creation and continued inward investment. It is important that the tax regime encourages economic growth and inward investment and also does not create disincentives for people to take up work when it is available, for example through high marginal rates and in particular where income tax interacts with income support.

1470. The recently published draft States Economic Growth and Diversification Strategy contains the following strategic aims:

- *Encourage innovation and improve Jersey's international competitiveness.*
- *Grow and diversify the financial services sector, capacity and profitability.*
- *Create new businesses and employment in high value sectors.*
- *Raise the productivity of the whole economy.*

1471. The States decided some time ago to focus on the provision of financial services as the Island's main economic activity. Tax reform since then has supported that, through the existence of "corporation tax" companies in the 1970s, the development of the exempt company in the 1980s, International Business Company in the 1990s and currently the zero/ten (0/10) company tax regime.

1472. Until the introduction of 0/10 Jersey was in the fortunate position that a high proportion of its tax revenues came directly from taxes paid by companies. The decision to comply with the European Union's Code of Conduct on Business Taxation, abolish the exempt company and International Business Company regimes and introduce 0/10 has meant that position has had to change. Individual Islanders have been required to contribute more of Jersey's tax revenues, though the introduction of "20 means 20" and GST. ITIS was also introduced which, among other things, allowed tax to be collected from individuals who came to live and work in Jersey for short periods of time and so ensure that more taxpayers paid the tax that was due.

1473. The alternative to introducing 0/10 was either to maintain the former 'non-compliant' regime and face the international consequences or to introduce a single, positive rate of tax for all companies in Jersey. Advice obtained at the time, and subsequently in the 2009 Business Tax Review, concluded that moving to a single, positive rate of tax would have a devastating effect on Jersey's ability to offer a tax neutral vehicle to clients of the finance industry, with a knock-on effect on the industry itself. Maintaining a 'non-compliant' regime would likely have resulted in unilateral action from other jurisdictions which could also have damaged the finance industry. It was estimated that introducing a positive rate of income tax for corporate "clients" of finance industry would result in the loss of up to 12,000 jobs. The financial burden on residents, whether individual or corporate, would have been significantly greater in that circumstance.

1474. This reform has inevitably changed the proportion of revenues raised from the taxation of individuals and the taxation of corporates. As highlighted above, there is a significant risk to the ongoing success of the finance industry, as well as other sectors, and hence a risk to economic activity and employment if there is a shift back in favour of taxation of corporates. Further information on this will be given in the forthcoming report on the taxation of non financial service companies.

1475. The more recent Fiscal Strategy and Business Tax review clearly demonstrated continued strong support to protect the financial industry.

1476. This support for the continued existence of the finance industry in Jersey has appeared to pay dividends. While the finance industry has been adversely affected by the ongoing global economic crisis, its existence still provides the greatest contribution, either directly or indirectly, to Jersey's economy.

1477. However, the risks of being highly reliant on one industry have also been felt. There may be benefit in diversifying the economy but there is also a need to balance diversification with the ability to raise revenues. A strong finance industry which contributes significantly to tax revenues will allow the Island to invest more in diversification.

1478. Current financial forecasts indicate that expenditure can be met from existing revenue sources but without substantial surpluses. This suggests that there is no need to raise any taxes but also there is little, if any, scope to reduce existing taxes. Further, based on the advice from the Fiscal Policy Panel, future surpluses should be used to rebuild the Stabilisation Fund.

What should Jersey's tax policy deliver

1479. Jersey's tax policy must support the economic and political policy objectives noted in the previous section.

1480. In order to do this Jersey's tax regime should have the following features:

- *Stability. Jersey has a reputation for stability in its tax regime, which is a key feature of its global offering. Investors, whether financial services related or not, considering the use of Jersey need to know how they will be taxed for the foreseeable future.*
- *Certainty. This is linked to the point on stability. Changes should be made infrequently, after careful consideration and consultation.*
- *Revenues. Jersey must raise sufficient revenues to meet its spending requirements.*
- *Flexibility. Where a need is identified, whether to attract new business or to defend existing business, Jersey must be able to move quickly.*
- *Competitiveness. In all things, Jersey must ensure that it does not damage the Island's ability to effectively compete for business. In this, the Island must keep aware of events in its key competitors and in the broader world which may affect it.*
- *Efficiency. Any tax changes should distort taxpayer behaviour as little as possible, unless that is one of the reasons for introducing the tax in the first place.*
- *Cost effective. The Fiscal Strategy Review, and resulting decisions by the States to increase GST and social security and retain a maximum income tax rate, suggest that in addition to the factors noted above, taxes should be cost effective for both the States and for taxpayers.*
- *Fairness and equity. These are extremely difficult to define and mean different things to different people. Recent decisions on introducing '20 means 20', the desire to modernise and simplify the tax regime and the introduction of GST 'protection measures' indicate that fairness and equity includes ensuring that the wealthiest pay a greater proportion of their income in tax while those on the lowest incomes are protected. It has also been recognised in recent decisions that the introduction of a competitive tax regime to encourage wealthy individuals and their businesses to Jersey is beneficial to the economy. In the absence of the direct and indirect revenues raised and economic activity derived from this inward migration the burden on taxpayers would be greater.*

Key tax policy principles

1481. With the above in mind, the following principles are recommended:

- *Taxation must be necessary, justifiable and sustainable.*
- *Taxes should be low, broad and simple.*
- *Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest incomes are protected.*
- *Taxes must be internationally competitive.*
- *Taxation should support economic development and, where possible, social policy.*

Taxation must be necessary, justifiable and sustainable.

1482. Taxes should not be raised for the sake of raising taxes, but with an identifiable spending need in mind. For example if a potential new source of revenues is identified, it should not automatically be adopted without considering whether the States has a specific requirement for more revenues, or if existing taxes should be reduced in response.

1483. It should be clear why any new tax is being introduced, and if any one sector or type of taxpayer is more affected, the reasons behind that should be made clear. Where the tax system discriminates between taxpayers, the rationale behind that should be clear.

1484. Taxes should also be sustainable in the long term. As such, it should be clear that revenues can be projected forward with a reasonable degree of certainty. Taxes should also not affect taxpayer behaviour such that the revenue stream dries up, unless that is the intention of introducing that tax to change behaviour, for example where a decision is made to intentionally increase the cost of unhealthy items like alcohol or tobacco.

Taxes should be low, broad and simple.

1485. Much of the output of Jersey's main industries (finance, tourism and agriculture) is exported. As a result, most businesses in the Island depend directly or indirectly on their ability to sell into the global market place. Jersey faces a high degree of competition in all of these sectors, and must remain competitive in order to continue to attract business. Low rates of tax are a feature of this.

1486. Simplicity is also a key selling point for international business, though this is more important for finance than for other sectors. Where a low or zero rate of tax can be obtained in a competitor jurisdiction with relative ease, international business will not be prepared to achieve the same result in Jersey through a number of complicated steps. Complexity adds cost and risk to a transaction, and business may not be prepared to accept either.

1487. Taxes should also be broad; an economy which relies too heavily on one particular sector or type of taxpayer or tax base for revenues will be at risk if that sector, taxpayer group or tax base falters. A broader based tax system, where as many sectors and individuals as possible contribute over a wider taxable base, is a more stable one.

1488. A broader tax base also supports the principle that tax rates should be low, as the greater the number contributing to revenues, the lower the rate of tax that each will be required to pay.

1489. Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest incomes are protected.

1490. The people who live in Jersey should contribute to the cost of the services they receive to the best of their ability. There have been many debates by the States in recent months, including those relating to the rate of income tax, the tax regime for wealthy individuals and the GST regime. The outcome of those debates suggests that the States broadly supports the current structure.

1491. This principle can be viewed from another equally relevant angle i.e. that all taxpayers should pay the tax which is rightly and properly due. To do this both the tax law and the application of that law must be robust.

Taxes must be internationally competitive.

1492. Jersey's tax system must enable it to compete with its key competitors to attract and retain business. This must apply not only to the types of business which currently use Jersey, but also to new business which the Island would wish to attract.

1493. It is important to monitor developments in competitor onshore and offshore jurisdictions and to ensure that there is good communication between government and industry on the best way to ensure Jersey's continued competitiveness.

1494. Compliance with international standards may be needed to ensure that international competitiveness is maintained as to do so can reduce the risk of action being taken against Jersey to deter investment. This is not the only reason for complying with international standards but is an important one.

1495. Taxation should support economic development and, where possible, social policy.

1496. While the tax regime cannot create economic growth in itself, it can work to support economic growth and it is important that it does not hinder it.

1497. Tax policy can support economic growth by reducing distortions in taxpayer behaviour, thereby improving economic efficiency. It can act to encourage economic activity to flourish thereby encouraging growth in employment.

1498. Taxes should not serve to deter investment, employment or diversification or act as a barrier to economic development. For example, the tax treatment of new businesses and start ups should not impose an unnecessary cost which again could act to stifle business growth. In this respect, taxes on income, rather than flat fees or charges, may be less economically damaging.

1499. Tax reforms can also remove incentives to act in a way which is not intended or desired. For example, the interaction of the income support system and the personal tax system should not act to deter people from taking up employment.

1500. Similarly the tax system cannot, and arguably should not, define social policy but where there is a clearly defined objective, and where it can be objectively demonstrated that the tax regime can affect taxpayer behaviour, then it may be appropriate to set taxes accordingly. One example of this may be environmental taxes, where taxes are set to encourage or deter a specific type of environmentally damaging behaviour, and the revenue collected is used to further encourage taxpayers to make "good" choices. Another may be the linking of increases in impôts to the States strategy on deterring alcohol abuse.

The way forward

1501. A direct comparison of Jersey to other jurisdictions such as the UK or other large jurisdictions is not necessarily appropriate in all cases. Being a small island, Jersey does not have the ability to develop a highly diversified economy which includes sectors with substantial geographical resource requirements such as manufacturing. As such Jersey needs a tax policy suited to the economic activity which it can support. Not all taxes will therefore be suitable for or relevant to Jersey and while global trends should be considered, the relevance and suitability of each should be determined by reference to Jersey's economy.

1502. This section takes the tax policy principles, together with the economic and political policy objectives to develop tax policy objectives and a recommended way forward.

1503. Based on the principles set out above, and taking into account the economic and political objectives, the recommended key tax policy objectives are:

- *Supporting economic growth, and hence employment growth, through providing a simple, stable and certain tax regime.*
- *Further supporting growth in employment by ensuring there are no barriers to people taking up employment.*
- *Maintaining international competitiveness through providing a low, broad and simple tax regime which complies with international standards.*
- *Ensuring taxpayers pay the taxes properly and rightly due to ensure that the current tax regime is sustainable and meets the Island's fiscal requirements. This may require simplification of the personal tax regime, enhancing the robustness of the tax legislation and improving enforcement.*

1504. This is not intended to be an exhaustive list of the objectives but those of primary importance.

1505. To meet these objectives the recommended focus of tax policy development in the medium to longer term, in the absence of any substantial factors which change the current policy objectives, is as follows:

- *No fundamental reform of key aspects of the tax regime. In the absence of any unexpected event, whether external or internal, there should be no fundamental changes to the key aspects of Jersey's tax regime being 0/10, a low, broad and simple GST regime and a stable personal tax rate. Fiscal certainty and stability are critical to encouraging economic growth.*
- *Continuing protection of 0/10 for the foreseeable future. This will include not only ensuring that it remains compliant with international standards but also ensuring that tax revenues are safeguarded so that the provision of a tax neutral environment, which is so important to the success of the finance industry, can be sustained.*
- *Ensuring the tax law applies as it is intended. To ensure that all taxpayers pay the amount of tax rightly and properly due, the tax law has to be robust and be drafted to achieve the policy intention.*
- *Consideration of the relationship between tax and social security contributions and benefits to ensure there are no barriers to people returning to work.*
- *Simplifying the personal tax system. Individuals need to understand their tax affairs in order to understand what they are being asked to pay. As Jersey considers the introduction of self assessment for personal tax, it will be necessary to simplify the current complicated regime. This will also help to safeguard tax revenues which in turn*

will assist in achieving a number of the economic and political objectives.

- *Ongoing monitoring of international developments. Jersey does not exist in a vacuum and does not have complete control over the direction its economy takes. International pressures, both governmental and regulatory, will continue to affect the Island and it will be important that these are prepared for, identified and responded to appropriately.*
- *Removal of barriers to competitiveness. Where these are identified, they should be removed. This will continue to be monitored and opportunities to improve competitiveness will be assessed on a regular basis. Flexibility is key. Where opportunities and threats exist, the Island must be alert to identify them and to act quickly in response.*
- *Consideration of the potential to widen the tax base. This would not be undertaken to raise a specific amount of additional revenues but to determine whether there is scope to make Jersey's tax regime more efficient and effective. There may also be opportunities to enhance competitiveness and ensure that everyone makes an appropriate contribution. This will initially focus on the way in which Jersey taxes property as taxes on property are coming under increasing focus globally and is an area which has not been fully explored.*
- *Changes to future tax revenues and States expenditure. The implications of the aging population on Jersey's future revenue and expenditure requirements are an important factor on which a substantial amount of work has already been done. The Tax Policy Unit, as part of Treasury, is linked in to this process and will, if necessary, consider the extent to which tax reform can or should be used to address the funding needs.*

Appendix II

Facing Up to the Future – 2004

Annex 1

The Potential Impact of Failing to Implement Corporate Tax Changes: *Jersey without an International Financial Services Industry*

In considering its options, the Committee has looked at how the Island economy might look *in the absence* of the international financial services industry at its present level.

This might be the outcome if the States failed to introduce measures to reform the corporate structure in response to the changes which are taking place in competitor jurisdictions.

It looked particularly closely at that part of the financial services industry that provides services to the international markets including those serving non-resident clients.

This industry is highly mobile and it would probably be the most profitable parts that would leave first if the Island's corporate tax structure became uncompetitive. There could be a substantial change in the structure of the financial services industry in the Island within a relatively short period.

There would be a major shock to the Island economy during the first few years after companies had gone, though they would be unlikely to leave the Island at the same time. The loss of some companies could have a bigger effect on the overall economy than others.

The following effects would be likely to be felt in the Island during the first few years after the shock of the emigration of these key companies:

- Employment in financial services would fall dramatically from today's level of 12,000 jobs to a level of 1,200-1,500 jobs
- A large fall in demand for goods and services (for example in the shops) since employees in the financial services industry generally have the highest disposable incomes and spending power
- Employment outside the financial services sector would also fall. Significant unemployment outside the financial services sector would be likely
- Property prices would fall and the age structure would alter as younger people would be likely to dominate the leavers, or those who no longer chose to come to the Island
- Total population would fall, and the fall could be considerable - possibly by 20-22,000 with the working population falling by 14-16,000
- Under the current tax structure, States revenue could decline by £250-£300 million per annum compared to the present total of £450 million
- If current levels of services were maintained, States spending could fall by much less (perhaps only by £100 million or less) because it would tend to be older residents who would remain in the Island and the immediate liability for pensions would hardly fall at all
- The potential deficit in the States Budget could amount to £200 million in each and every year
- The potential tax base on which to make up this shortfall would be much smaller than it is now
- To meet any shortfall by tax increases or service level reductions would require higher tax rates, or deeper cuts, than meeting a similar shortfall from the current tax base.

The Island would probably begin to recover after this initial shock, but the economy would look very different from the way it does now. Exactly how the economy would look would depend on what, if anything, replaced financial services. In the absence of a replacement the following chain of events would be likely to unfold after the first few years following the shock:

- Wages in the Island would fall as firms would be able to offer lower wages with the rise in unemployment and in response to the decline in overall profitability
- To maintain anything like the current population an alternative export industry would be required. This industry would need to be one where any additional costs arising from Jersey's physical location were at least off-set by some cost or quality advantage of operating from the Island
- Assuming such an industry could be found, output in the Island would start to recover, though almost certainly with much lower levels of profits and wages compared to now
- Population would stabilise, and might even start to grow again, though the new people coming in to the Island would have a different set of skills
- House prices would stabilise, but very likely at levels considerably lower than now. It is likely that many younger people would find that their mortgage debts were larger than the (now lower) value of their properties.

If the population had fallen significantly (which is likely) it might take a considerable time for property prices to recover. The problem of "negative equity" in property could last for a considerable time.

The reduction in both property prices and wages would make tourism and, possibly, agriculture more competitive. In the absence of a significant new industry they would probably become the dominant industries again in Jersey.

Unless any new industry was capable of generating similar tax revenues for the States and wages for residents it would not be possible to maintain the current position of low tax rates with similar public spending per head as the UK. Either tax rates would need to increase very significantly (ie up to the equivalent of UK rates) or public services would need to be cut drastically. If the former was adopted high-income residents, particularly those with significant investment income, would be discouraged from remaining in Jersey because of the higher tax rates. To the extent that such residents left the Island this would lead to further downward pressure on tax revenues.

Exactly where the economy would end up is impossible to predict with any accuracy as there are too many unknowns. However, the typical pattern for small Island economies is that they tend to have lower average (economic) standards of living than their relevant 'mainland'. Among other things this reflects the additional transport costs of getting to and from the Island. The exceptions are where the Island has some clear and significant underlying economic advantage over the mainland. In the case of Jersey there is currently little evidence that the advantages of the Island for agriculture or tourism are that significant. The economic value of the Island's characteristics for these two industries may, therefore, be limited. As a result, levels of Gross National Income per head might fall from the present level of £24,000 to £25,000 (in 2003 - based on £21,000 in 1999 and inflated by 4% per annum) to around or below the average UK level - £18,000 (2002), once the economic adjustments had worked through the Island.

The delivery of the current level of public services combined with the current tax structure could result in a deficit in the States Budget of around £200 million every year. This is not sustainable, even in the short term, so some very large adjustments in either taxation or spending would be needed.

Conclusion

In the absence of a high profit, high wages, alternative, the flight of international financial services from Jersey would lead to an economy that could not sustain the current public services on the current tax structure.

This loss of tax revenue would be likely to be bigger than the shortfall produced by altering the tax structure to meet the changing competitive conditions in international financial services, and thus keeping this business on Jersey.

In addition, the total economic activity on the Island would be likely to be lower, but with a less than proportionate decrease in the demand for public expenditure (including States' pensions). The net result is that for any given level of public services delivery, tax rates for residents would be likely to be significantly *higher* in the absence of the international financial services business.

Appendix III

Code Group assessment findings – 1999

Measure	Code Group description	Reason for harmful finding
Tax exempt companies	A resident company may elect to be treated as tax-exempt within Jersey. A tax-exempt company must either be beneficially owned by non-residents or be a collective investment fund. Income tax is not payable on income arising to a tax-exempt company outside Jersey nor on bank interest arising in Jersey. The fees for an exempt company total £600 a year.	Exemption for non-Jersey source income and local bank interest (also applies to collective investment vehicles). No Jersey shareholders permitted.
International treasury operations	An international treasury operation based in Jersey as a branch of an international bank may deduct, in arriving at taxable income, a percentage of profits deemed to be applicable to the cost of outside expertise and other costs.	Applies to international loan business. Activities taxed at effective rate of 2%.
International Business Companies	An International Business Company (IBC) is subject to tax on profits from international activities at the following rates: Profits up to £3 million - 2 % £3 - £4.5 million - 1.5 % £4.5 - £10 million - 1 % Over £10 million - 0.5 %. Jersey source income and all other income of an IBC is taxed at 30 %. No Jersey resident may have any interest of any sort in the company.	Sliding scale for profit of international operations 2% to 0.5%. No Jersey resident may own shares.
Captive insurance companies	Jersey applies the principle that captive insurance, to the extent that it insures only the risks of its shareholders (parent, partnership or sole proprietor) is mutual business and consequently not taxable. The captive's investment income is taxed at a rate of 20 %, subject to a deduction for management expenses and foreign tax. A captive may, however, operate as an exempt company if it can demonstrate to the Jersey fiscal authority that it will bring 'adequate economic benefit to the island'.	Insurance businesses not taxed. Investment income taxed at 20% subject to management charge, etc. Can operate as an exempt company.

Similar measures were also found to have harmful effects in the Isle of Man and Guernsey.

Appendix IV

Comparative analysis of the Crown Dependencies company tax regimes

Jersey approaches 0/10 in a different way to Guernsey and the Isle of Man, in that in general it taxes the company that carries on a particular activity, rather than the income. In this, the scope of profits subject to tax at 10% or 20% in Jersey is greater than in the other islands because profits derived from other activities but earned by the company in question will be taxed in Jersey, while in Guernsey and the Isle of Man they will not.

In addition, the range of activities that can lead to a company being taxed at 10% or 20% is higher in Jersey than in Guernsey or the Isle of Man. However, there is no evidence that the 0% rate is anything other than the general rate of corporate tax, based on statistics previously provided by the States Statistics Unit and Comptroller of Taxes.

20% rate

Jersey taxes a greater number of utility companies than Guernsey does (Guernsey Water and Guernsey Gas are not taxed at 20% though their Jersey equivalents are). The Isle of Man imposes no tax on utility companies, and indeed does not have a 20% rate for companies on any income.

Because the tax treatment relies on the regulatory position of the company in question, differences in the regulatory regime between Jersey and Guernsey could mean that entities carrying out broadly similar functions in each island could be taxed differently. The most obvious difference between the lists of entities regulated to carry out a public telecommunications activity is that Jersey Airport and Harbours are included in Jersey's list, while their Guernsey equivalents are apparently not so regulated in Guernsey. Currently, the practical impact of this is minor, because Jersey Airport and Harbours are part of the States and so not subject to income tax, but should the proposed incorporation of these activities proceed as planned, they will become taxable and thereby increase the scope of the 20% tax band accordingly.

Jersey and Guernsey tax income derived from domestic land and buildings at 20% while the Isle of Man taxes it at 10%. All three islands tax income derived from mining or quarrying activities, along with income derived from the development of property.

10% rate

Jersey taxes banks, trust companies, investment businesses, fund administrators and fund custodian companies at 10% on all of their income. By contrast, Guernsey only taxes the income that banks derive from customer deposits and from their minimum regulatory capital, and income derived by any company from the provision of certain credit facilities (in practice this is mostly confined to the provision of leasing and hire purchase facilities). The scope of the Isle of Man's 10% rate for financial services companies is even narrower, with only the income derived by a bank from customer deposits currently being taxable.

Overview

Tax rate	Jersey	Guernsey	Isle of Man
20%	Named utility companies: *Postal services* A person authorized to convey letters by a licence granted under the Postal Services (Jersey) Law[1] *Electricity services* The Jersey Electricity Company Limited *Telecommunications services* A person licensed to run part or all of a public telecommunications system under the Telecommunications (Jersey) Law 2002[2] *Other* The Jersey New Waterworks Company Limited	Income derived by utility companies regulated by the Office of Utilities Regulation from those regulated activities. As at 8 August 2012 these were: *Postal services* Guernsey Post Limited *Electricity services* Guernsey Electricity *Telecommunications services*[3]	N/a

	The Jersey Gas Company Limited *Property income* Income from land and buildings in Jersey including property development and quarrying etc Income from the importation and distribution of hydrocarbons	 *Property income* Income from land and buildings in Guernsey including property development and quarrying etc	
10%	Regulated banks, trust companies, investment business companies, fund administrators and fund custodians	Banking income arising from the reinvestment or utilisation of customer deposits, or arising from the bank's minimum regulatory capital, Income arising from the provision of credit facilities to customers including the provision of hire-purchase facilities but excluding loans to connected parties	Income derived by licensed banks from their banking business (i.e. from taking deposits from customers and lending it on) Income derived from the letting or development of land and property, or from the mining or quarrying of land in the Isle of Man Income of a trading company which has made an application to be taxed at the 10% rate
0%	All other income/companies	All other income	All other income/companies

Utility companies referred to in the table above

These are, per the CICRA website on 8 August 2012: (http://www.cicra.gg/post/licensee_framework.aspx)

- Citipost DSA Limited
- Hi-Speed Freight Services Limited
- Hub Europe Limited
- Jersey Post Limited
- Regency Holdings Limited
- TNT Post UK Limited

[2] These are, per the CICRA website on 8 August 2012: (http://www.cicra.gg/telecoms/licensee_framework.aspx)

- BT Jersey Limited
- Cable and Wireless Guernsey Limited
- Cable and Wireless Jersey Limited
- Clear Mobitel (Jersey) Limited
- Cronus Consultants Limited
- Crown Castle UK Limited (now trading as Arqiva Services Limited)
- Foreshore Limited
- iConsult (Jersey) Limited
- Interactive Online Limited (Localdial)
- IT Consultancy Limited
- Itex (Jersey) Limited
- Jersey Airport
- Jersey Electricity Company Limited
- Jersey Harbours
- Jersey Telecom Limited
- Jersey Telenet Limited (now trading as Jersey Airtel Limited)
- Links Communications
- Marathon Telecom Limited
- MRS Communications Systems Limited
- National Transcommunications Limited (now trading as Arqiva Limited)
- Newtel Limited
- Nitel Limited
- PSINet Jersey Limited
- XKO Communications Systems (Jersey) Limited (now trading as 2e2 Limited)

[3] These are, per the CICRA website on 8 August 2012: (http://www.cicra.gg/telecoms/licensee_framework.aspx)

- 2e2 Guernsey Limited
- Cable & Wireless Guernsey Limited
- Clear Mobitel Guernsey Limited
- Futura Limited
- Guernsey Airtel Limited
- Guernsey Net Limited
- Itex (Guernsey) Limited

- JT (Guernsey Limited) (formerly Wave Telecom)
- Links Communications
- LP Telecom Limited
- Microtech Limited
- Newtel (Guernsey) Limited
- Y Tel Limited

Appendix V

Oxera report: The economic impact of specific potential changes to the taxation of, or application of charges to, specific activities in Jersey – October 2012

The economic impact of specific potential changes to the taxation of, or application of charges to, specific activities in Jersey

Note prepared for the States of Jersey

October 11th 2012

1 Introduction

Oxera has been asked to look at the potential economic impact of three specific potential changes to the tax (or charges) structure for corporate entities supplying goods or services in Jersey. The three specific changes are:

– extending the scope of the 10% corporate income tax categories, particularly to the retail sector;

– applying a charge on companies (and potentially excluding some or all of the companies within the 10% or 20% bands);

– restricting the recoverability of GST paid on inputs, either in general or in relation to specific activities.

2 Extending the scope of the current corporate income tax bands

Applying a differential rate of corporate income tax to specified activities would have two effects. One would be to create an incentive to move activities, and in particular profit, from the category of activity that is taxed (or taxed at a higher rate) to a category that is not taxed or taxed at a lower rate, and the second would be to change the costs of providing the goods or services in question, which may lead to a change in the price of those goods or services to end-users, or some other adjustment in the economy.

In Jersey the application of a tax on the profits of corporate entities has a differential impact depending on whether the business in question is owned by Jersey residents, or owned by shareholders resident in other jurisdictions. A typical example of the latter would be where the Jersey operation is a subsidiary of a company incorporated in, say, the UK.

2.1 Jersey resident-owned companies

Where a company is owned by Jersey resident shareholders, there is an interaction between the income tax levied on the profits of the company and the liability of the individual shareholder when those profits are distributed to the shareholder. The current position is that where a Jersey resident-owned company is subject to 0% tax on corporate profits, the shareholder would face a liability of 20% personal income tax on any profit distributed as a dividend (and any distribution or transfer of wealth to the shareholder that is broadly equivalent to a dividend).[1] The application of a tax on corporate profits under these circumstances creates a credit that the resident can use to offset their personal tax liability on the dividend received.

Therefore, if the corporate tax rate is set at 20%, no further tax liability is incurred by the shareholder on receipt of a dividend. If the corporate tax rate were set at 10%, a further 10% would become payable upon receipt of the dividend.

The impact on Jersey resident shareholders of a change in the corporate tax rate from 0% to 10% is therefore limited. When the corporate tax rate is 0%, the tax liability is applied to the shareholder at the time the dividend is paid by the corporate to the shareholder. As a result, (and assuming the dividend payments, or equivalent, do not change), the total received by the shareholder that they can spend (ie, their personal income after tax) is the same, and they receive the income at the same time. This is set out below in Table 2.1.

Table 2.1 Impact of difference in corporate profit tax rates on disposable income of Jersey resident owners (£s)

	Tax rate on corporate profits	
	0%	10%
Profit 100		100
Tax on profits	0	–10
Dividend (pre tax)	100	100
Personal tax on income @ 20%	–20	–20
Credit for profit tax already paid	0	10
Total available for the shareholder to spend	**80**	**80**

Source: Oxera calculations.

In terms of cash flow, there is a slight advantage for the corporation from being in the 0% category. Until the dividend is transferred to the shareholder the corporate has access to the entire profits from past operations, while when the corporate is subject to profits tax, it has access to only the post tax profit. If subject to the 0% corporate tax regime rather than 10%, companies reinvesting or investing in new assets would have access to somewhat more internally generated capital.

Under most circumstances, the impact on the corporate entity will be to reduce their cost of equity capital slightly. In the particular circumstances where a company, for whatever reason, has difficulty accessing additional external capital and it wishes to expand or undertake

[1] This assumes that the shareholder already falls into the 20% personal income tax band. If not, the shareholder might pay 0%, if they have unused personal allowances or 27% if they have exhausted their allowances but have a total income that is below the 20% threshold.

significant additional investment, the additional internally generated capital that does not have to be paid as corporate profits tax can help provide this. A company in an expansion phase is also less likely to be paying dividends, so the timing advantage may last longer. At the margin, therefore, this move (on its own) should have a positive impact on investment in the economy.[2]

From the government's perspective, the timing advantage gained by the company in effect by paying the tax on profits only when the profits are distributed is the mirror image of the disadvantage that applies to the government—it receives the tax revenues later. If, as a result, some other tax has to change to compensate, or public expenditure is reduced, there will be additional effects in the economy. Exactly what these changes are will need to be included when determining the impact on corporates, in order to arrive at the complete impact on the economy.

Hence, for Jersey resident-owned companies, the move from a 0% category to a 10% category will have some, limited, effect of increasing their costs. If the company generally pays out most of its profits in dividends (or equivalent), the impact is small. If the company is in expansion and making significant investments, the effect is larger. However, the maximum effect is limited to the time value of the money that the corporate uses for investment that it would otherwise have paid the government in the form of corporate profits tax.[3]

Moreover, for Jersey resident-owned companies, even moving them into the 20% category would just take them back to the position (in terms of costs) that they were in prior to the introduction of 0/10.

2.2 Companies owned by non-Jersey residents

For companies owned by non-Jersey residents, the position is rather different, and the impact will depend, at least partially, on the jurisdiction within which the owners of the Jersey company are based. For UK parents of Jersey companies in particular, changes in the taxation arrangements in the UK mean that moving these companies into the 20% tax rate category does not necessarily bring them back to the position they would have been in prior to 0/10.

2.2.1 Prior to 0/10

Prior to 0/10, corporate profit tax paid in Jersey by subsidiaries of UK companies did not tend to influence the total profits tax that would be paid by the parent company on the operation of the Jersey subsidiary. This position arose because any tax paid in Jersey (at, say, 20%) was offset against the liability for UK corporation tax (at say, 30%). Hence a profit of £100 made in Jersey would be taxed for £20 in Jersey, and an additional £10 in the UK, making the total £30 (ie, the total makes up the UK 30% tax rate). Hence, if the Jersey subsidiary was subject to 0% in Jersey, the parent company would have to pay £30 in the UK. The overall total tax paid on the Jersey £100 profit would be £30, irrespective of how much was paid to the Jersey government. Like the position of the Jersey-owned company, there were some timing advantages in paying less tax in Jersey, but if profits were routinely transferred to the parent company these would tend to be relatively small.

However, the UK corporate tax structure has been changed, and as at 2012 corporate profits tax paid in Jersey will not generally be offsettable against any further UK tax liability on that profit. Moreover, it is now also the case that, in general, the UK does not further tax the

[2] There are other tax structure interventions that can have a similar impact. For example, some forms of capital allowances can have the same effect of delaying the payment of tax on profits.

[3] This conclusion is based on net profits of the corporation being eventually transferred to shareholders and taxed as shareholder income. To the extent that a corporate manages to transfer profits to shareholders in a form that is not taxed as income for the shareholder, the impact of moving from 0% to 10% or 20% is more significant.

profits of overseas subsidiaries, especially where those subsidiaries are carrying on a clear business operation (eg, running a retail outlet).

As a result, for UK companies prior to 0/10, the rate of profit tax in Jersey was not a significant cost to their operations, so they did not obtain a significant cost reduction as a result of moving into the 0% category.[4] However, subsequent changes to the UK corporate tax structure have made the 0% rate in Jersey a benefit. For these companies, the UK reform reduced their total corporate tax liability. As a result, a move to apply a corporate profit tax rate of 10% (or 20%) in Jersey would now represent a net cost to these companies. Their total corporate tax bill would rise, although it would still generally be less than it was prior to 0/10 and the reforms of the UK structure.

2.2.2 Future impact

In looking forward, therefore, the move of UK-owned companies from the 0% category to the 10% (or the 20%) category would in general raise their total tax liability. Hence it would represent an increase in the costs to the shareholders of those companies of doing business in Jersey.

In the face of an increase in the costs of doing business in Jersey, those businesses have a number of options. They could absorb this additional cost, and accept a lower (post-tax) return to their Jersey operations; they could increase the prices they charge in the Jersey market, to compensate for the higher tax burden; they could increase their productivity, reducing unit costs; they could (try to) reduce the price they have to pay for input, including labour. (These options are not mutually exclusive, and in practice companies may adopt some or all these approaches.)

Critically, the ability to raise prices profitably will depend on the market dynamics that each company faces. If the market for their output is mostly supplied by companies that face the same type of tax cost increase, and the market is reasonably competitive, the cost increase would be expected to feed through into price increases. This is the outcome expected when a competitive market faces a ubiquitous cost shock. However, given the recent history of the Jersey market, there are some complicating factors. In particular, the price responses to changes in tax burdens may take some time to materialise. If, in these markets, the price response to the earlier change in the UK tax structure (which reduced the cost of doing business in Jersey) has not already fed through, the cost increase that would now take place may not result in a future price rise, but rather halt an expected fall in prices (or, more likely, stop a slowing-down of future price rises).

If the market is mostly supplied by companies that are Jersey resident-owned, it would be expected that it is these companies that are setting the price in the Jersey market. As the total cost of tax for these companies is relatively unchanged (mostly owing to a timing issue—see above), the prices they charge would not be expected to change as a result of the move from 0% to 10% (or 20%). UK-owned suppliers would, therefore, be constrained from raising their prices by the presence of Jersey resident-owned suppliers.

If the market for Jersey suppliers is constrained by direct importation (eg, Internet shopping), this will also limit the ability of UK-owned, Jersey-based suppliers from raising their prices in response to the increase in their total tax costs.

The likely overall impact on prices paid by Jersey residents as a result of a move of a particular sector of the economy into the 10% (or 20%) corporate profits tax band is, therefore, dependent on the prevailing market conditions in that sector. Where the sector is made up of mostly UK-owned companies, and those companies have already reflected the

[4] For some large multinational companies with significant operations in jurisdictions with a corporate tax rate higher than the UK, profit tax paid in Jersey was a net cost to their operations.

advantage they gained from changes to the UK tax system in prices charged in Jersey, this move would be expected to increase the price of goods or services sold, thereby partially or fully offsetting the increased tax costs that these suppliers face.

In the parts of the economy where Jersey-owned companies dominate, the move into the 10% (or 20%) tax band would be expected to have little, if any, significant impact on the total costs that the Jersey-owned companies face, and hence prices charged in the market. Where Jersey-based suppliers face strong competition from direct imports, their ability to raise prices to compensate for any increased total tax costs is limited. Where UK-owned suppliers have not yet reflected the advantage they gained from the recent change in UK taxation in Jersey prices then, again, the impact of any move to the 10% (or 20%) tax band would be expected to be muted.

Overall, therefore, where a sector of the economy is moved into the 10% (or 20%) band and this generates a significant level of net additional taxation for Jersey (ie, the suppliers will generally not be Jersey resident-owned), there is likely to be a price reaction, and Jersey customers will end up paying for most or all of the additional tax-take enjoyed by the government. Where the tax does not generate significant new revenue (ie, the sector to which it is applied is mostly Jersey resident-owned and the impact is therefore mostly in relation to the timing of tax receipts), there is less likelihood of residents paying for that (relatively small) additional tax revenue through increased prices.

It follows that if the retail sector has been chosen partly because of the preponderance of non-Jersey resident-owned establishments, this increases the probability that any additional tax revenue generated will be passed on to Jersey residents.

If there were a move to put the retail activities into a category that was moved into the 10% tax band, the order of magnitude of the tax generated would be at around £5m in a year like 2009 (the last year for which the profit breakdown by sector is available).[5] However, as indicated above, some of the tax generation is just tax that would have been paid later where the retail businesses are owned by Jersey residents. In addition, to arrive at this figure, the underlying data is based on the companies being taxed being allocated to a single category, and it is likely that some companies are included where not all their activity would be retail. In addition, once such a targeted tax is applied, there will be an incentive to rearrange business activities so as to minimise the activity classed as retail, and to reduce the measured profitability of that sector. Hence, the £5m indicated above may be an overestimation of even the gross tax revenue that the application of a 10% tax rate to retailing might generate.

3 Applying a charge to undertakings

3.1 General application

As a general rule, any charges applied to undertakings in a way that has an impact on all, or most, of any particular segment of the economy will be passed on to consumers (in the form of higher prices) or to labour (in the form of lower wages). Under restricted circumstances, shareholders may experience lower returns, particularly in any transition to a new equilibrium. However, in an open economy with relatively free movement of capital, a permanent reduction in the return to capital as a result of a charge placed on undertakings is unlikely.

In particular, in the short-term, transitional phase of economic adjustment, the precise economic impact of applying charges to undertakings will depend on the basis of the charge

[5] Oxera analysis of Jersey tax data. The definition of retail services used here is SIC codes 12 (Nurseries), 164 (Retail Distribution, Food and Drink) and 166 (Other Retail Distribution).

(eg, per employee, per square footage of occupied premises) and the category or categories of the undertakings affected if the charges are selective (eg, if they apply only to retail functions).

If the charges are applied across the whole economy, they become an additional cost to doing business in Jersey. As a result, where import substitution (or, more precisely, moving away from Jersey the activity that will cause the charge to be incurred) is possible, imports will become cheaper to supply relative to doing the same activity in Jersey. To continue to compete with imports, the Jersey-based activity will need to reduce some other input cost—likely to be labour costs (eg, lower wages) or less use of land (eg, less floor space). Furthermore, to the extent that the imported activity is not a perfect substitute, some of the charge will end up in the higher prices charged in Jersey.

Where import substitution is not possible, the charge will act as a uniform cost shock to Jersey provision, and so will generally be reflected in prices.[6] If, in turn, this reduces total demand, there may be a subsequent reduction in the demand for labour, and hence labour costs (ie, wages) could also fall (slightly).

If the output is generally exported, it may not be possible for the price to rise without Jersey production becoming uncompetitive. As such, over time the cost of some other inputs (eg, labour, land) will need to decrease (eg, through lower wages); otherwise, production in Jersey is likely to reduce.

Hence, the overall effect of applying a charge to undertakings is to raise prices, reduce wages, or to reduce the use of, and hence price of, other inputs such as land or occupancy space. In practice, the response of the economy is likely to be a mixture of these effects.

However, because charges will be attached to a specific input, one effect of such a structure is to increase the relative price of that input. So, for example, if the charge is per employee (or full-time equivalent employee, FTE), the cost of labour rises relative to the cost of other inputs. At the margin, capital is likely to be substituted for labour, and demand for labour decreases. So, in addition to the general impact of charges (see above), the specific nature of the charge will also have an impact on the relative use of resources in Jersey. Applying the charge to labour reduces the demand for labour; applying the charge to land/occupancy reduces the demand for that input, etc.

Finally, a charge that is levied at a set rate on a specific input (eg, a specific charge per FTE of labour) will have a higher proportionate impact on final prices where the current cost of that input is low. In the case of labour, the proportionate increase in costs will be higher for low-paid workers than for high-paid workers, which in turn is likely to mean that the proportionate increases in prices will be higher in relation to the output of the low-paid workers compared with the high-paid workers. This creates the potential for these types of charges to have regressive distributional impacts if the low-paid workers tend to disproportionately buy outputs that are also provided by low-paid workers. Other charging structures (eg, a charge on the use of space) could have other distributional consequences (potentially progressive) if, for example, high-paid workers disproportionally purchase goods or services that use a large amount of this input. The precise distributional impact will depend on the detail of the charge, and the current (indirect) consumption of the input to which the charge applies.

[6] Any new equilibrium position will be likely to have some, relatively small, component of a reduction in the costs of other inputs, so the full cost of the charge may not be reflected in increased prices.

3.2 Selective application

If the charge is applied selectively (eg, to a specific set of institutions because of the activity they undertake), issues will inevitably arise over the boundary definition. An incentive is created to move economic activity from the part of the business to which the charge would apply, to one where it would not. So, for example, if the charge applies at an institutional level to employees of retail establishments, the retailer that sub-contracts its back-office functions and logistics to a subsidiary would pay less in the way of charges than one that undertook these activities within the retail operation.

To overcome this incentive effect, the charge can be applied by reference to the specific job done. However, this increases the complexity of the application of the tax, as there will now be an incentive to re-classify particular jobs out of the charged activity (eg, shop assistant) and into some other activity (eg, within-store logistics manager).

This boundary problem is less acute if there is some other cost that would apply if the boundary is crossed. Applying the charge to all institutions other than those subject to positive rates of corporate profits tax could ease this problem, but an incentive would remain to organise the corporate structure such that employees are located in the institution subject to the profits tax (assuming that the charge is per FTE), while the profits emerge from the institution subject to the employee charge. To the extent that these types of organisational changes are successful, any tax/charge revenues are reduced, but, more importantly, to the extent that doing this itself uses up economic resources, the overall economy becomes less efficient and less competitive.[7]

4 Reducing the recoverability of GST within the production chain

4.1 General

The economic impact of GST (and VAT) is designed to be a tax on consumption. The tax rate is applied to the (untaxed) costs of production—ie, the untaxed price of the goods or services in the end-consumption market. However, GST (or VAT) is levied at each point in the production chain, but GST paid on inputs (ie, what is purchased) is offset against any GST liability due to the government as a result of sales. The net tax paid is therefore based on the value added to goods/services as they pass through an intermediate stage in the production process.

By making the recoverability of GST paid less than 100%, the effective rate of GST in the end-consumption market is raised; how much it rises depends, however, on the number of intermediate stages and the proportion of the value added in each stage. At one extreme, if the (GST) tax-paying institution buys no inputs, its GST payments to the government would not change.[8] At the other extreme, a pure retailer that bought in as much of its inputs as possible would create a small value added on its own account compared with the value (ie, price) of the goods/services it sold. This type of operation would see a significant increase in the total amount of GST paid. If this pattern of operation were repeated along the production chain, the difference in the effective GST component facing the end-consumer in the end-price can be significant.

[7] An incentive is created to spend real economic resources to reduce the tax paid up to the value of that tax saving. However, this sort of economic activity has no, or very little, value to society and as such is a deadweight loss to the economy.

[8] A farmer growing a food crop sold directly to consumers and using seed saved from the previous year could (just) fall into this category. More realistically, some service providers (eg, economic consultants) have very low purchase values for inputs compared with the value of their outputs, and therefore approximate a business that would be relatively unaffected by making GST not fully recoverable.

Example: with a 5% GST rate, a restriction on recoverability to, say, 80%, and a five-stage production process (with 20% of value added at each stage), the effective GST rate would be around 7% to the end-consumer. [9]

This type of tax structure would therefore encourage the vertical integration of companies, and, to the extent that companies purchase inputs from each other, conglomeration. More importantly, this tax structure creates barriers to entry for small, specialised suppliers either to other companies (which will not be able to recover in full any GST they have to pay), or to end-users (as the supplier will not be able to recover all the GST they have paid on their own inputs).

In addition, other distortions can occur—for example, by acting in the production chain as an agent, rather than a principal, it may be possible to avoid some of the GST that would otherwise not be recoverable.

GST (and VAT) structures have, among other considerations, been designed especially to achieve two objectives: neutrality with respect to imports/exports; and neutrality with respect to the organisational structure of the supply process. The Jersey structure has also been designed to be as simple as possible, in order to minimise the deadweight costs to the economy of actually administering the tax. Introducing a mechanism that limits the recoverability of GST removes the first two general characteristics and could create additional complications for the Jersey system, especially if the non-full recovery were limited to certain sectors of the economy (see below).

The actual impact on the final price faced by consumers in Jersey is complex because the impact on the costs on different suppliers is not uniform. For the reasons set out above, it will vary by the number of stages through which the goods pass and the way services are put together. Where most of the market is supplied in the same way, such a tax structure could be expected to have a uniform impact on costs, in which case it would be expected that the increase in tax paid to the government would be balanced by the increase in prices faced by consumers. If the market is supplied in a multitude of different ways, the outcome could be different. If the price-setters in the market have only a few taxed links in their supply chain, it would be their (very limited) increase in costs that would be expected to be reflected in the price increase in the market. Suppliers using more links would be expected to have to absorb any further tax increases that their supply configuration suffered. Under these circumstances gross tax receipts could be marginally higher than the price increase faced by consumers.[10] However, if the price-setters are currently those with more links in their supply chain, the opposite result could materialise: the price increases faced by customers could be marginally higher than the increase in tax revenues received by the government.

Finally, the fact that GST is not fully recoverable in Jersey would make *direct* import by retail consumers marginally more attractive than purchasing through a GST-registered retailer. By directly importing (and paying the required GST), the end-customer avoids the double payment of the irrecoverable part of the GST that the retailer would pay on importation.

As indicated, such a tax structure creates an incentive for vertical integration and conglomeration, and creates (additional) tax barriers to the entry of niche suppliers. Given the small size of the Jersey market, anything that makes new entry more difficult may also have an impact on the overall competitiveness of the local market place, which in turn may have additional detrimental effects on consumers.

[9] See Table 4.1 below for the details of this outcome.

[10] However, if the added complexity increases the administrative costs of collecting the tax, the net increase in government revenues could still be below the additional tax paid by customers.

As with the other taxes or charges, the non-full recovery of GST could be limited to specific classifications of business. For example, as in the other examples above, it could be limited to retailers (ie, classification by institution), or to retail sales (ie, classification by activity). Although such an approach could avoid, at least partially, the multiple-stage problem identified above, it would increase the complexity of the system, thereby tending to increase the deadweight loss of running the GST system. In addition, both approaches immediately create an incentive for those with the tax liability to the government to avoid being put (or having the transaction being put) into the disadvantageous category. This in turn can increase the deadweight costs of the structure since any activity designed just to reclassify activity has no economic value.

More importantly, however, if the identification of retail sales were perfect, the impact would generally be the same as raising the level of GST, but with the additional incentives to vertically integrate and bring in-house any bought-in services. The more the retailer does in-house, the lower the level of value in the final price that has some sticking tax applied to it. For example, if the retailer itself contributes to 50% of the untaxed value of the product, the non-recoverable element of the GST would apply to the other 50%. So, if the rate were 5% and the recoverability were limited to 80%, the additional tax would be 20% of 5% of the 50%, which is 0.5%. The effective GST rate would be 5.5% for this retailer. However, for the specialist retailer that buys in all their services (eg, bookkeeping, payroll functions, etc) and has a low retail cost model with their own value added at, say, 25% of the untaxed price, their GST sticking tax would be 20% of 5% of 75%, or 0.55%. For these specialist retailers, the effective GST tax rate would therefore be 5.55%.

Other specific categories of institution or transaction could be singled out for not being able to recover all their input GST. However, the same overall issues would arise:

– increase in complexity (and thus deadweight loss to the economy);

– incentive to distort the categorisation of the institution or transaction, inducing more deadweight loss;

– increasing the cost base of goods and services available in Jersey by an amount that could be more, less or the same as the increased tax revenues;

– a potentially negative impact on the costs of provision of exports (see below).

4.2 The position of exports

For conventional exports, any GST paid on inputs is recoverable from the government. As a result, these exports are free of GST (which is the mirror image of levying GST on the value of imports). Although it would be possible to continue to allow the full recovery of input GST by the exporter, in relation to those exports this would not necessarily mean that some additional non-recoverable GST would not stick to exports (and the system would also become more complex.) This outcome arises because if the non-recoverability has occurred earlier in the production chain, the ‘stuck’ GST has been incorporated into the intermediate price of the goods or services. As this element cannot usually be identified easily, it may not be recovered by the exporter. For example, in the five-stage process in the earlier example above, the price and the GST components are as set out in Table 4.1 below.

Table 4.1 Non-recoverability of GST and exports (£s)

Stage in the production/distribution process	Value added	Cost of bought-in goods/services (excluding GST)	GST paid (to the government)	GST recovered	Price in the market including GST
1 20		0	1		21
2 20		20.20	2.01	0.80	42.21
3 20		40.60	3.03	1.61	63.63
4 20		61.21	4.06	2.42	85.27
5 Jersey consumption	**20**	**82.02**	**5.10**	**3.25**	**107.12**
5 for export	**20**	**82.02**	**0**	**4.06**	**101.21**

Source: Oxera.

Although the exporter is able to recover all the GST it has paid on its inputs (4.06), this does not mean that it will recover all the GST paid further along the production chain. The final export cost/price is £101.21, while, under full recoverability, it would be £100 (ie, 5 * 20).

This dynamic would also apply to the financial services sector in Jersey, including those who are registered as International Service Entities. At present, International Service Entities can recover any GST they pay on their inputs (or purchase them without GST) in return for a lump-sum payment to the government. Even if this system remained allowing for full recovery, where there is a multistage production process, the earlier sticking of the GST would not be recoverable (or, at least, a complicated system would be required to allow for this).

5 Conclusion

The application of the three proposed changes to the tax (or charges) structure in Jersey, whether applied across the whole economy or selectively targeted, would cause knock-on effects in the Jersey economy. In most cases these ramifications are likely to result in Jersey residents paying for any increased tax (or charge) revenues generated, through higher prices or wages lower than they would otherwise be, in the medium to long term.

Under some specific circumstances this may not be the outcome. In particular, where the market is currently dominated by Jersey resident-owned suppliers and the change is in the categories of activity that are subject to 10% or 20% corporate profits tax, the additional tax collected by the Jersey government may be higher than the impact on prices. However, given that, in these cases, the market is dominated by Jersey resident-owned suppliers, the amount of additional revenue generated is likely to be small.

In the other cases where the market is dominated by UK-owned suppliers, an increase in corporate profits tax is likely to feed through into either higher prices or lower wages (or, possibly, a reduction in the use of some other input). The additional tax revenues will be paid for largely by Jersey residents.

The application of charges or the non-full recoverability of GST will also have the effects of:

– making exports more expensive;

– making imports cheaper relative to on-Island production;

– increasing the complexity of the tax/charges structure;

with charges also:

– changing (reducing) the relative demand for the item upon which the charge is levied (eg, if employees then the demand for labour);

and non-full recoverability of GST:

– providing an incentive to vertically integrate;

– making entry by niche players more expensive, and potentially reducing competitive pressure.

The appropriate tax structure will depend on the objectives being pursued. If the objective is to raise additional government revenue then, compared with the options considered here, there are likely to be alternative approaches that are more economically efficient (ie, that create less deadweight loss in the economy). For at least some of these, it may be possible to target them in a way that can meet distributional objectives (in terms of progressiveness or regressiveness), if appropriate.

However, if the objective is to target companies that currently do not pay corporate profits tax, but supply goods and services into the domestic market, these three approaches have limited effectiveness and, in most cases, it will be Jersey residents who actually pay the tax or charge. This is particularly the case in relation to charges and non-recoverable GST, where both Jersey resident-owned and non-Jersey resident-owned suppliers are subject to the additional tax or charge in the same way, resulting in the additional tax or charge applying to all the Jersey-based suppliers in that particular market.

Appendix VI

Bibliography

Reports previously issued

Year	*Title*
2004	Facing up to the Future: reforming public spending and taxation to sustain a prosperous and competitive economy
	States of Jersey Finance and Economics Committee
2004	Fiscal Strategy: Background paper
	Oxera
2004	The reform of public spending and taxation (report accompanying States proposition where the States agreed to the introduction of 0/10)
	Finance and Economics Committee
2005	Fiscal Strategy (report accompanying States proposition to introduce a package of measures to make up the revenues foregone from 0/10, including GST and 20 Means 20)
	Finance and Economics Committee
2006	Zero/ten design proposals
	Treasury and Resources
2008	Deemed rent proposal
	Treasury and Resources
2008	Deemed rental charge on non-finance non-Jersey-owned companies: Green Paper
	Treasury and Resources
2010	Fiscal Strategy Review: green paper consultation
	Fiscal Strategy Review: supporting research
	Fiscal Strategy Review: summary of responses to consultation
	Treasury and Resources/Involve
2010	Report on International Standards for the States of Jersey in connection with a Business Tax Consultation
	Deloitte
2010	Business Tax Review: consultation document
	Treasury and Resources

2011 Summary of responses to Business Tax Review consultation

Treasury and Resources